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IRAN: THE FINANCIAL ASPECTS OF THE HOSTAGE SETTLEMENT AGREEMENT

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LETTER OF TRANSMITTAL

To the Committee on Banking, Finance and Urban Affairs:

This staff report is in response to my request of January 20, 1981, with the concurrence and support of J. William Stanton, our Ranking Minority Member, for a very detailed analysis of the financial aspects of the Iranian hostage settlement agreement. The report is the result of a bipartisan staff effort to review all the relevant information both classified and public, to interview the participants, and to report with recommendations on further action, if required, on all aspects of the Iranian hostage settlement agreement relevant to the jurisdiction of this Committee.

This report does not review the national defense aspects of the Iranian matter nor does it concern itself with the issue of why the Shah of Iran was admitted to the United States. These questions have been or should be the subject of detailed review by other Congressional committees.

The staff's report focuses on the November 1979 freeze of Iran's assets and the settlement agreement concluded fourteen months later. This report is the first detailed public review of the overall financial aspects of the hostage crisis, and in particular of the issue when, why and by whom an assets freeze was first discussed. Examining the process by which a freeze was considered and ultimately imposed is important because, once such a precedent as the Iranian assets freeze has occurred, U.S. domestic and international financial circles cannot ignore the potential adverse effects such a precedent could have on U.S. participation in the international financial community.

The report is structured so as to review in detail the evolution of the Iranian matter from the first consideration of the assets freeze through the hostage settlement agreement, including a review of certain specific allegations pertaining to the Iranian matter. I urge the Members of this Committee to carefully review this very detailed staff analysis.

Based upon the staff report, it is my opinion that:

(1) There is no doubt that President Carter's actions with reference to the International Emergency Economic Powers Act (IEEPA) were in compliance with the letter and spirit of that Act. Quite obviously, the Iranian matter was a circumstance constituting, in IEEPA's terms, an "unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security and foreign policy * * * of the United States." Based upon the extraordinary threat to our nation's security and foreign policy, the Iranian matter was a valid political decision by President Carter. On the other hand, whether the Iranian matter constituted an extraordinary threat to the economy of the United States, under the standards of IEEPA, is far more debatable.

(2) In those areas reviewed by the staff, it appears that with few exceptions, U.S. Governmental sources failed to recognize the importance of the Iranian student and clerical authorities, relying instead upon Iranian secular sources who in terms of internal Iranian politics were relatively uninfluential and unable to deliver on either their promises or their threats. Such was the case with Iranian sources beginning with the Shah's caretaker government headed by Shahpur Bakhtiar and including officials of the provisional government headed by Mehdi Bazargan. The same was true with President Bani-Sadr and his man in charge of Bank Markazi, Ali Riza Nobari.

(3) For approximately the first 11 months, the informal negotiations conducted by U.S. commercial bank representatives with Iranian intermediaries, with the knowledge of U.S. authorities, were the only substantive dollars and cents negotiations attempting to find an overall solution to the financial situation. More importantly, these negotiations, involving draft after draft of settlement language and documents, centered on settlement conditions knowingly more advantageous to U.S. commercial banks than to non-bank claimants. The sole responsibility of the bank negotiators was to protect the interest of their clients and not to act as negotiators on behalf of all U.S. claimants. Meanwhile, for procedural and substantive reasons, non-bank claimants lacked similar access to avenues for resolving their claims. The U.S. Government appeared to be less concerned with resolving the problems of non-bank claimants than those of the banks. For bureaucratic reasons, the responsibility for negotiating and drafting a settlement agreement on behalf of the non-bank claimants was the task of the State Department and was separated from the activities of the Department of the Treasury which was preoccupied with the commercial bank aspects of the settlement agreement. When comparing the settlement conditions providing for immediate payoff of certain bank debts with the potential for future payment of their debts, the non-bank claimants may have felt lost in the shuffle. While surely there is exaggeration in the charges made by some non-bank claimants that the settlement was unfair, it should be noted that, in the future, steps should be taken within the Executive Branch to prevent bureaucratic precedents, turf battles, and constituencies from affecting the outcome of financial settlements under IEEPA.

(4) Nine months before the hostages were seized, during a period when economic conditions were relatively calm in Iran, and in a time in which there was no evidence that Iran might withdraw its funds, legal technicians in the Department of Treasury concluded that the conditions for invoking IEEPA existed. Such a case for a freeze made at that time on economic grounds was tenuous at best. The "emergency" apparently resulted from the alleged vulnerability of the U.S. banking and financial system to the threat of a withdrawal of Iranian assets. Prior to this time, the Administration had consistently held, in Congressional testimony and elsewhere, that the U.S. financial system could *not* be threatened by withdrawal of all or any portion of OPEC's assets. Despite this longstanding Treasury position, the Treasury lawyers analyzing the situation in February 1979 were basing their conclusions on a frighteningly broad interpretation on what constitutes an economic emergency under IEEPA.

In November 1979, when the hostages were seized and a freeze once more came under consideration, the political and economic grounds

justifying the use of IEEPA were examined again. Foreign Minister Bani-Sadr's threat to withdraw Iranian assets became a critically important justification for the freeze because of the sensitivities of several U.S. friends and allies, particularly Saudi Arabia and Kuwait. For the same reasons as existed in February, however, the Bani-Sadr threat did not present a plausible economic danger to the U.S., based on the consistent Treasury position to that effect. Clearly, the main justification for the freeze (and an entirely legitimate one) was political—the need by the Administration to respond forcefully to the taking of the hostages and the support for the taking offered by Ayatollah Khomeini. Indeed, indications are that a consensus to proceed with a freeze had been reached well before Bani-Sadr's statement and Treasury Secretary Miller's early morning call to President Carter recommending a freeze.

In light of the expansive interpretations given to the economic emergency authority under IEEPA in some government quarters during the Iran crisis, it would now be appropriate for the Congress to provide future administrations with clearer guidance as to those circumstances which should constitute an economic emergency under IEEPA.

(5) There was minimal consultation with Congress at certain critical junctures in the hostage crisis, characterized by the early morning notice to House leadership and Committee chairmen that the President was about to institute a freeze. While the timing and depth of that consultation may be consistent with existing law, consideration should be given to clarifying the scope of Congress' role in the consultative process.

(6) The extensive telephone contacts by Department of Treasury and Federal Reserve Bank officials the weekend prior to the official announcement of an assets freeze provided an opportunity for experienced bank officials to deduce that an assets freeze was to take place in the not too distant future. If a freeze is to remain confidential until the point of a Presidential declaration so that banks could not act to thwart the freeze, the data collection by U.S. Governmental agencies pertaining to foreign deposits in U.S. financial institutions and other relevant commercial information must be kept more up-to-date than apparently is possible under the existing data collection process. Also the entire reporting requirements on foreign deposits or equity investments in the United States should be reviewed.

(7) The role of Chase Manhattan Bank and its Chief Executive Officer David Rockefeller in influencing the financial aspects of the hostage crisis is much overstated. The study indicates that Mr. Rockefeller, who was personally acquainted with the Shah, was not an intimate associate to the degree that is often assumed. No evidence has been found to verify that Chase Manhattan Bank was the depository for the alleged billions of dollars which the Shah had purportedly transferred from Iran either directly or indirectly through other sources such as the Pahlavi Foundation. From all indications, Chase Manhattan Bank and its financial posture were not subjects discussed during any of the talks pertaining to the admission of the Shah to the United States. There is no evidence that either Chase or Rockefeller attempted to persuade the U.S. Government to impose a freeze of Iranian assets, nor did they have control over the timing of the freeze or any advance knowledge of the freeze other than by means of inferences they may have drawn from Government inquiries on the status of Iran's assets

just before the freeze. Any analysis of the balance sheet of Chase Manhattan Bank throughout the course of the Iranian matter would conclude that even if the worst case expectations pertaining to Iranian loan repudiation and deposit withdrawals were to have taken place, Chase Manhattan Bank would not have been rendered insolvent. If total Iranian loan repudiation and deposit withdrawal would have taken place, Chase Manhattan Bank would have had serious earnings problems but its existence would not have been threatened.

(8) The long-term effects of the Iranian assets freeze on the U.S. economy and on U.S. domiciled international institutions should be reviewed. The extraterritoriality of the Iranian assets freeze certainly was inconsistent with the rationale for the formation of a Eurodollar market.

As yet there is no clear indication what effect the Iranian freeze has had on the U.S. position in international markets. Although there are some indications that there has been a decline in dollar deposits maintained by nations belonging to the Organization of Petroleum Exporting Countries (OPEC) in U.S. banks' foreign branches or subsidiaries, it is dangerous to attribute the decline to the assets freeze. Worldwide reduction in the importation of oil, along with abundant OPEC production of oil, has resulted in a softening of oil prices, reduced profits to OPEC nations, and smaller dollar deposits. In addition, at least some OPEC countries have been embarked for some time on a course of diversifying their U.S. deposits. Additionally, there appears to have been no adverse impact on U.S. banks' ability to be the lead bank in international syndications. However, the long-range implications of the Iranian assets freeze on U.S. banks should be the subject matter of hearings by this Committee.

(9) Finally, it was the decision of the Iranian clerical leaders, not Bani-Sadr or the other Iranian secular leaders, to end the hostage crisis. The timing of that decision, the format of the settlement agreement, and all other specific items pertaining to the resolution of the crisis, were the result of the clerical factions' decision. While it is impossible to logically deduce the thought process of this illogical clerical faction, it must be assumed that the Carter Administration's playing of the so-called Reagan Card (the fear that Reagan would terminate all negotiations), combined with the very severe economic impact the war with Iraq was having on Iran and Iran's need for readmission to international financial circles, were some of the reasons for the change of spirit by the clerical faction.

The final deal was not as good a deal for Iran as the one that was being drafted by the secular leaders such as Bani-Sadr and Ali Riza Nobari of the Bank Markazi; recommendations from the secular faction were never readily accepted. The clerical faction, not the U.S. government negotiators, the U.S. bank negotiators, or anyone else, made the decision as to the timing and terms of the hostage settlement agreement.

Chairman, House Committee on Banking, Finance and Urban Affairs.

PREPARATION OF THE STAFF STUDY

This staff study was prepared by Michael P. Flaherty, General Counsel; Wm. Lawrence Hollar, Assistant Counsel; Graham T. Northup, Deputy Minority Staff Director; Paul Gunnar Nelson, Minority General Counsel; James C. Orr, Minority Counsel, International Affairs; Phyllis Stone, Staff Assistant.

The findings of this report are based upon extensive research of all public materials, the examination of classified materials, and interviews with those who participated directly or indirectly in the implementation of the freeze, the Iranian Settlement Agreements, or both.

Among those interviewed were:

Richard Davis, Assistant Secretary for Enforcement and Operations, Department of the Treasury.
James Oltman, General Counsel, Federal Reserve Bank of New York.
C. Thorne Corse, Senior Vice President and Assistant General Counsel, Bank of America.
Mark Feldman, Deputy Legal Adviser; and Andrew Sens, Deputy Director of the Iran Office, Department of State.
Patrick Mulhern, General Counsel, Citibank; Richard Simmons (Cravath, Swaine, and Moore), Attorney for Chemical Bank; Robert Webster (Winthrop, Stimson, Putnam and Roberts), Attorney for Irving Trust Company.
Leonard Santos, Attorney, International Affairs Division, General Counsel's Office, Department of the Treasury.
Ernest Patrikis, Deputy General Counsel, Federal Reserve Bank of New York.
Roberts Owen, Legal Adviser, Department of State.
Robert Carswell, Deputy Secretary of the Treasury.
John Hoffman (Shearman and Sterling), Attorney for Citibank.
Harold Saunders, Assistant Secretary for Near-East and South Asian Affairs, Department of State.
Russell Munk, Assistant General Counsel, International Affairs Division, General Counsel's Office, Department of the Treasury.
Robert Mundheim, General Counsel, Department of the Treasury.
Lloyd Cutler, Counsel to President Carter.
Francis Logan (Milbank, Tweed, Hadley and McCoy) and Robert Douglas, Attorneys for Chase Manhattan Bank.
David Newsom, Under Secretary of State for Political Affairs.
Bruce Nichols and Donaldson Pillsbury (Davis Polk and Wardwell), Attorneys for Morgan Guaranty Trust.
David Rockefeller, Chairman, Chase Manhattan Bank.
Paul Volcker, Chairman, Board of Governors, Federal Reserve System.
Mark Johnson, Desk Officer, Department of State.

Lisle Widman, Deputy Assistant Secretary for International Monetary Affairs, Department of the Treasury.
C. Fred Bergsten, Assistant Secretary for International Monetary Affairs, Department of the Treasury.
G. William Miller, Secretary of the Treasury.
Warren Christopher, Deputy Secretary of State.
Anthony Solomon, President, Federal Reserve Bank of New York.
Robert Armao, Aide to the Shah of Iran.

There are many others who were interviewed who, for purposes of this investigation, requested to remain anonymous. Notes of these extensive interviews are available for inspection by Members of this Committee.

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I. THE FREEZE, WHEN AND WHY

President Carter's order freezing Iranian deposits in U.S. banks and their foreign branches and subsidiaries on November 14, 1979, received worldwide attention and elicited questions that were both political and legal in nature. The taking of the hostages at the U.S. Embassy in Tehran on November 4 had led to consideration of, and later imposition of, a variety of U.S. economic sanctions against Iran, including the freeze. Yet the possibility of using the International Emergency Economic Powers Act to freeze Iranian assets was first considered within the Executive Branch many months before the taking of hostages at the U.S. Embassy. As part of the U.S. government's response to the uncertainties in Iran around the time of the Shah's overthrow, a freeze of Iranian assets was considered as early as December 1978, and detailed analytical memos on the subject were written by U.S. government officials as much as nine months before the student militants overran the U.S. Embassy and began the 444-day hostage ordeal. This section of the report describes the U.S. government's attitude and actions with respect to a freeze in the period before hostages were taken on November 4, 1979.

Every President in recent history has had at his disposal the ability to institute economic sanctions against any country whose actions met the criteria required by the Trading with the Enemy Act (50 U.S.C. App. §§ 1 et seq.) and more recently the International Emergency Economic Powers Act (50 U.S.C. §§ 1701 et seq.) (IEEPA). In recent history such freezes have been imposed on the assets of the People's Republic of China, North Korea, Cuba and Vietnam.

One might expect, based on the U.S. Government's experience with freezes, that standards exist for when economic sanctions, including an asset freeze, might be considered as part of routine contingency planning, and when normal monitoring of the political and economic activities in a country give way to extraordinary surveillance of the situation in that country. The following paragraphs discuss the events in Iran and address the question whether standards on these matters really exist in the Treasury and State Departments.

In the case of Iran, the period of extraordinary surveillance began during the first week of November 1978, almost one year to the day prior to the November 4, 1979 taking of hostages. By November 5, 1978, a working group had been established in the State Department for the purpose of fine tuning the "Emergency and Evacuation Plan" for Iran. This working group was composed of employees of the State Department who had been assigned to the Iranian Desk, as well as employees from the International Communication Agency, the Pentagon, and other intelligence agencies. A series of increasingly violent incidents and demonstrations that occurred in Tehran and other major Iranian cities, including some incidents both in the vicinity of the U.S. Embassy and involving U.S. commercial offices, led to the establishment of the State Department working group.

Beginning on December 26, 1978, Undersecretary of State for Political Affairs David Newsom formally organized an inter-agency task force on Iran involving some forty members from eight U.S. Government agencies. The task force had the operational responsibility to draw down the official presence of U.S. citizens in Iran. While instituting such an inter-agency task force was hardly novel in these types of circumstances, the Iranian situation required more than routine efforts due to the magnitude of the U.S. presence in Iran. In late 1978 there had been as many as 40,000 to 45,000 Americans in Iran, about 1,500 of whom were there in an official capacity. The task force's assignment was made more complex by a variety of factors: the large number of U.S. citizens whose lives were potentially endangered in Iran; the $12 billion in U.S. military sales contracts entered into with the Government of Iran; the many other private sector contractual commitments between U.S. and Iranian parties; two sensitive intelligence monitoring stations; and the Iranian oil production that was important to U.S. domestic and foreign policy interests. Within 60 days after it was formally established, the interagency task force had developed a plan resulting in the reduction of the number of U.S. citizens in Iran to approximately 2,000, and all but $1 billion of the $12 billion in U.S. military sales contracts had been diverted to other purposes.

In addition to the activities of the State Department Iranian working group and the Newsom interagency task force, the Special Coordinating Committee (the SCC) was actively involved during this period. This Special Coordinating Committee, whose meetings were chaired by Zbigniew Brzezinski or his deputy David Aaron, organizationally was part of the National Security Council. Its members included the State Department, Department of Defense, the Joint Chiefs of Staff, the Central Intelligence Agency, Treasury, and sometimes the Office of Management and Budget. The SCC met to discuss developments in Iran virtually on a daily basis during late 1978 and early 1979, as the crisis worsened. The Committee's interests included the details of the evacuation plan being developed by the Iranian working group in the State Department and implemented by the Newsom interagency task force, as well as the general U.S. policy with regard to the changing situation in Iran. The Committee was a forum for lively debates in December 1978 about whether Americans should be evacuated from Iran at a faster pace in order to protect their lives, or whether such a move would seem to signal a U.S. abandonment of the Shah. These debates continued in the Newsom group during January 1979.

There is a striking contrast between the seriousness of the disruptions in the political sphere as compared with the economic sphere in Iran between December 1978 and February 1979. Politically, this period was one of exceptional turmoil that warranted extreme vigilence. Events during that time included: Daily demonstrations against the Shah: riots in the oil fields with the potential for serious disruption of oil exports; the January 16, 1979 departure of the Shah from Iran "for an extended vacation"; a greeting by an estimated one million people for Ayatollah Khomeini upon his February 1, 1979 return to Iran after 15 years of exile; the February 11, 1979 resignation of the

Shah's caretaker government headed by Shahpur Bakhtiar. This resignation was under pressure from Ayatollah Khomeini who then appointed Mehdi Bazargan to lead a provisional government. Finally, there was the attack on the American Embassy in Tehran on February 14, 1979 after which the Iranian Deputy Prime Minister personally led a group of revolutionary guards to obtain the release of the captured Embassy personnel.

On the other hand, the economic situation in Iran during the December 1978–February 1979 period was serious enough to call for close monitoring by the U.S., but it was hardly as chaotic as the political sphere:

Despite months of political turmoil, and despite some general threats by Ayatollah Khomeini to repudiate contracts with U.S. firms negotiated by the Shah, Iran remained up-to-date on the repayment of the vast majority of its debts to U.S. financial institutions. Iran even took pains, in March and April 1979, to publicly reassure nervous foreign lenders that it intended to continue paying its debts.

Even though Bank Markazi (the Iranian central bank) had faced strikes like most other Iranian governmental institutions, the central bank, in an effort to make sure Iran's credit rating was not tarnished, was more meticulous than usual in keeping its creditors informed when payments were as little as 2 or 3 days late. Relatively minor problems arising in telexes relating to what person in the Bank Markazi had authority after the revolution to sign official documents (problems which the New York Fed and other foreign central banks would naturally consider crucial) were quickly resolved.

U.S. banks that were polled by Chase Manhattan Bank, as agent for three large multi-bank loans to Iran, refused to consider calling any of the Iranian loans.

At least some offices in the Treasury Department were convinced that the Iranian upheaval was not a threat to the U.S. banking system. A Treasury Department memorandum in January 1979 addressing the vulnerability of U.S. banks to withdrawal of Iranian deposits concluded:

> There are two reasons why U.S. banks would not be particularly vulnerable to a sudden withdrawal of Iranian deposits. First, Iranian deposits with U.S. banks have varying maturities which stretch out over months if not years. Second, banks have immediate access to several alternative sources of funds which have evolved to support an essential function of banking—maturity transformation.

This view that U.S. banks were not particularly vulnerable to foreign withdrawals is consistent with longstanding Treasury Department policy. Treasury's Assistant Secretary for International Affairs, C. Fred Bergsten, testifying before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Banking Committee on April 5, 1977, said of OPEC deposits in U.S. banks:

> Well, if they took them out of the American banks, where would they put them? Only in the Eurocurrency [market]. Then, because of the way interest rates would react to that and because of the workings of the interbank markets, the money would be funneled back largely to the banks from which they came in the first place. That is not just theory; that is fact.

Similarly, in response to written questions raised by Congressman John Cavanaugh, then Treasury Secretary W. Michael Blumenthal stated that:

> As a practical matter, deposits withdrawn from a bank or banks must either be redeposited directly in another bank(s) or used to purchase goods, services, or investments, with the proceeds from these sales being placed in the banking system in the absence of monetary policies designed to sterilize such funds.

(This January 10, 1978 letter appears in the Congressional Record of February 23, 1978 at H 1403–1408. The quoted statement appears at H 1408).

Shortly after the Shah left Iran, both Treasury and the Federal Reserve Bank of New York provided favorable comments on a General Accounting Office report that found that even a massive OPEC sale of U.S. securities or withdrawal of deposits from U.S. banks very likely would have a minimal impact on the U.S. financial system. In an April 19, 1979 letter to GAO, Assistant Secretary Bergsten said:

> We agree with much of the report's discussion on the effects of withdrawal of OPEC deposits from the U.S. and the view that seems to emerge that such action would create problems, but not of a catastrophic nature. . . . We recognize, of course, that a sudden, massive attempt, whether by OPEC countries, by other foreigners, or by Americans, to convert into other currencies dollar assets held in the U.S. or abroad, could adversely affect the dollar exchange rate.

New York Fed President Paul Volcker, in an April 13, 1979 letter to GAO commenting on the report, said:

> We agree with the general thrust of the report that [OPEC financial] holdings do not themselves present a significant potential for affecting adversely the U.S. financial system or economy. Our financial institutions and markets have coped well with the massive international flow of funds that have developed in recent years in the wake of major increases in energy prices and other dislocations in the world economy. The Federal Reserve and Treasury working together have shown that they can deal effectively with major surges in financial flows, and we see no grounds for undue concern about our ability to handle future challenges of this sort.

Naturally, since Iran's holdings formed only part of the overall OPEC holdings, the impact of a withdrawal by Iran alone would have been even less significant than the report and comments suggest would occur after an OPEC withdrawal.

It should come as no surprise, then, that top government officials at Treasury and State were generally wary about imposing freezes. Aside from freezes being unnecessary to prevent permanent flight of foreign assets from the U.S. banking system, freezes also create uneasiness among foreign bankers and business executives, and a weakened position for the U.S. in international financial circles. When the surprisingly placid economic conditions in Iran during the December 1978–February 1979 period are combined with the traditional wariness on the part of top professionals at State and Treasury about the impact of a freeze, it is reasonable to assume that high level consideration in the U.S. Government of an Iranian assets freeze would have been quickly dismissed. Yet a freeze was, at that same time,

getting much more than routine consideration in both the State and Treasury Department. Indeed, the Treasury Department was prepared with draft freeze regulations as early as February 1979. Those draft regulations later became the basis for the regulations issued after President Carter's freeze order on November 14, 1979.

In a February 12, 1979 legal memo requested by the Office of General Counsel, the issue of an assets freeze was the subject of serious analysis. The memo noted that IEEPA was available if the President declared a national emergency. While the author disclaimed any intent to urge that IEEPA be invoked, he pointed out that the political step needed to trigger IEEPA—a national emergency—was no more extraordinary than what formerly would have been needed to trigger the Trading with the Enemy Act, before that Act was revised. Putting aside political considerations, the author advised that from the legal standpoint, the situation then prevailing in Iran in February justified the use of IEEPA. Not only did Congress intend IEEPA to cover just that type of situation, the memo said, but the case law would support the President's decision to declare a national emergency as a political judgment which courts traditionally refuse to second guess. Meanwhile, the author said, Treasury lawyers would continue to look into whether banks and other claimants had private, self-help remedies against Iran. Attached to the memo were draft Department of Treasury Iranian Assets Control regulations.

A memo signed two days later, on February 14, 1979, again requested by the General Counsel's office, contained a detailed discussion of the potential for United States claimants to use some form of protective "self-help" without the imposition of a governmental freeze on Iranian assets within the United States.

During the same period in which the General Counsel's office was preparing these analyses of the procedural requirements and the format for a freeze of Iranian assets, Treasury's International Affairs Office was also concerned with the situation in Iran. The office began to gather current information on Iran's U.S. assets and liabilities, and in February 1979, at the request of Deputy Secretary Carswell, updated U.S. portfolio capital movements vis-a-vis Iran. Reports from the New York Fed to Treasury showed that Iran had transferred $400 million to the Bank for International Settlements on February 2, 1979 and $650 million to three U.S. banks on February 8. While these movements from Iran's account were sizeable, and were particularly interesting because of the heightened U.S. concern about Iran's financial intentions, they apparently were requested by Iran for routine payment and liquidity purposes and were not a signal of economic warfare against the U.S.

High officials in the International Affairs Office, apparently in response to a request from the Interagency Task Force chaired by the State Department's David Newsom, also considered the economic ramifications if Iran began to withdraw its funds from the U.S. or convert its dollars into another currency. This inquiry included advice

on the legal framework available to protect the dollar and U.S. financial institutions in the event of serious financial problems with Iran.

One legal memorandum prepared in support of this inquiry by the International Affairs Office listed two alternatives available to protect the U.S. economy in the event of serious problems with Iran:

> The United States has two alternative legal remedies at its disposal in seizing Iranian assets in the U.S. The first and most sweeping remedy is the use of the power to freeze assets and block transactions pursuant to the International Emergency Economic Powers Act (IEEPA), created by Title II of Public Law 15–223 [sic] (December 28, 1977). The second, less drastic remedy is for the United States and private parties to pursue their creditor interests in U.S. courts within the limitations of the Foreign Sovereign Immunities Act of 1976.

These efforts at Treasury were in concert with activities at the National Security Council's SCC and the Newsom Interagency Task Force.

Some of the tentative conclusions about Iran that officials in Treasury had reached by mid-February 1979 included the following:

American banks collectively (worldwide) probably held Iranian deposits in excess of their credit exposure to Iran. Iranian official agencies, in particular, appeared to have larger sums on deposit with American banks than they owed to the banks;

The U.S. Government also held Iranian funds in amounts which substantially exceeded current government claims on Iran. (This did not, however, take into account possible contract cancellation claims of American manufacturers);

All Iranian assets in the U.S. could be frozen and all financial transactions blocked on the basis of a special Presidential declaration of a national emergency related to Iran;

Assets of private Iranian residents might be able to be attached, but Iranian official agencies probably could not be reached in this way.

In sum, while we have found no evidence of requests from any U.S. financial institutions or any other sources for an assets freeze, and while there was no apparent justification on the basis of Iran's economic posture for anything more than close monitoring of economic developments in Iran (a monitoring which disclosed no unusual happenings), there was much more than routine contingency planning in the Department of the Treasury during this period with regard to a freeze. Nine months before the provocation of the November hostage seizure, and without any serious threat of economic warfare directed against the U.S. by Iran, the Treasury Department had laid the legal groundwork for a freeze on Iran's assets. At least in part the need for a freeze was bolstered by Treasury's view that self-help remedies would not be available to U.S. entities with a stake in Iranian assets.

Aside from the substance of Treasury's view on a freeze, the lack of coordination between the legal and economic divisions at Treasury resulted in duplications of effort, varying degrees of analysis, and multiple responses to the requests for information relating to possible economic sanctions, including an assets freeze. Obviously, the Office of Foreign Assets Control, from a bureaucratic perspective, was much more interested in the necessity for, and the implementation of, a freeze

because of its responsibility for administering the grandfathered activities of the Trading with the Enemy Act and IEEPA. The strong hand of the legal division and its concern for the protection of U.S. financial institutions, during the January–February 1979 Iran crisis, was to be repeated during the November 1979 crisis and the settlement process. In contrast, the International Affairs Division of Treasury, which did play a role in the February period, was far less essential to the policy and analytical support processes in November and throughout the hostage crisis.

At the State Department, discussion of a freeze was more subdued, perhaps because Treasury, not State, was the lead agency on financial aspects of a freeze. Certainly David Newsom's interagency task force had the possibility of some form of economic sanctions on its agenda. At the bureaucratic level, a February 2, 1979 memo prepared within the Bureau of Economic and Business Affairs at State discussed in general terms the President's authority under IEEPA and the provisions of the Foreign Sovereign Immunities Act. The memo noted that Iran had ordered a portion of its holdings in United States securities to be sold by the New York Federal Reserve Bank (a movement of funds of which Treasury was also aware). It went on to discuss the laws that could apply to the situation, although the office in which the memo was prepared was not involved in implementing either the Foreign Sovereign Immunities Act or IEEPA. It appears that the purpose of the memo was purely for internal information within that office and was not a prelude to policy action by the State Department.

From late February 1979 until the November hostage crisis, the economic situation in Iran remained strained but showed some signs of improvement:

There was some communication with the revolutionary government, and the Iranian government began to develop proper channels for the initiation of contract review talks.

Private contacts with Iranian officials and businessmen were less likely to be laced with revolutionary spirit and satanical references to the U.S.

Representatives of prominent U.S. banks in Tehran advised the Economic and Commercial Section of the U.S. Embassy they believed there was no real threat by Bank Markazi or other Iranian officials to repudiate pre-revolutionary debt to U.S. financial institutions.

Aside from the slowness of payment on debt to U.S. banks, which to a great degree was the result of the new management of Bank Markazi and its unfamiliarity with payment mechanisms, the principal complaint of U.S. banks was their lack of compensation for the nationalization of their banks or banks in which they had an equity interest.

In August 1979, when the solvency of the military sales trust fund maintained by the Department of Defense on Iran's behalf had been assured, the U.S. government agreed to a limited resumption in the supply of spare parts for U.S.-origin military equipment.

The State Department perspective on the economic environment in Iran from March to November 1979 is summed up in the following excerpt from a State Department chronology submitted in February

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1981 by Assistant Secretary Harold Saunders to the House Foreign Affairs Committee:

> In an effort to cooperate in restoring Iran's economic health, in the spring of 1979 we cautiously began to advise American businessmen to resume contacts with their Iranian partners in order to resolve the many complex commercial disputes. We wanted to see a resumption in the flow of spare parts and components for Iran's industrial establishment as a means of helping the Iranian labor force return to work. A restored economy could support increased political stability. From March to November 1979 Iran's oil sales to the U.S. were maintained at about pre-revolution levels.

The principal exception to what appeared to be an improving economic climate was Chase Manhattan Bank's relationship with Iran. Chase had been singled out for criticism by the Iranians, primarily because of its identification with the Shah. Allegedly the Chase identification with the Shah was both professional and personal.

There is little doubt that the best banking account in Iran under the Shah had been that of the National Iranian Oil Company (NIOC). NIOC oil payment dollars flowed through accounts at Chase at the rate of as much as $300–$500 million a week during 1979. There is also little doubt that during the Shah's reign a major factor in the awarding of the NIOC accounts to a financial institution was the Shah's approval of that particular institution. While the degree of the personal closeness between David Rockefeller and the Shah is much overstated, such a relationship did exist, and did influence the placement of NIOC accounts in Chase Manhattan Bank. What was a blessing in the days of the Shah quickly became a curse in the days of the Ayatollah.

Without regard to the merits of the business relationship with Chase, one of the major anti-American economic moves made by the new post-Shah government, symbolic more than financially damaging, was the winding down of the NIOC account with Chase by the fall of 1979 and the channeling of NIOC oil payments through other banks, including Bank of America. Even had Bank of America and other U.S. banks not attempted to take advantage of the Iranian's strong sentiments against the Shah, David Rockefeller, and Chase Manhattan Bank, there was little doubt that the shift of the NIOC account from Chase Manhattan Bank was inevitably to become one of the revolutionary tenets of the new regime. Interestingly, the fact that other major U.S. banks were selected to handle the accounts Chase lost is some indication of the apparent stability in U.S.-Iran economic relations after the revolution as well as an indication that Iran could not avoid continued contact with U.S. banks to handle dollar transactions with U.S. companies.

Much of mid-1979 was spent by contractors, banks, and U.S. government officials in Iran trying to reestablish at least a semblance of the economic ties that American businesses had previously enjoyed with Iran. Despite some of the revolutionary rhetoric that dominated Tehran, hopeful signs were developing that business opportunities for U.S. firms could be reestablished. Cautiously, the commercial attachés in the U.S. Embassy were encouraging American businesses to consider dealing with Iran. This era of somewhat improved relations came to an end with the taking of hostages at the U.S. Embassy on November 4, 1979.

The November 4, 1979 seizure and taking of more than fifty American citizens as hostages at the U.S. Embassy in Tehran brought an abrupt termination to the period of political and economic monitoring and precipitated a series of political and economic decisions by President Carter.

For a short period of time after the taking of the hostages there was still a sense that the student militants would soon turn over the Embassy and the hostages to the Iranian government, as they had done that previous February, if the Iranian leadership would assert its authority. The Iranian Foreign Minister had indicated that such a move was underway in a conversation with Charge d'Affaires Bruce Laingen while Laingen, Political Counsel Victor Tomseth, and Security Officer Michael Howland were held in the Iranian Foreign Ministry during the first few days of captivity. During those days Laingen was able to stay in contact by telephone with the Department of State in Washington while the hostages at the Embassy were cut off from outside contacts.

By November 6th, the optimism that a release might be imminent was shattered when it became apparent that the official Iranian authorities were unwilling to help free the hostages. Ayatollah Khomeini publicly endorsed the taking of the U.S. Embassy and hostages by the student militants. Also on November 6th, the political situation become more disrupted when the Bazargan Government resigned and power was assumed by the revolutionary council.

Immediately after the attack on the U.S. Embassy, the Department of State mobilized a working group on a 24-hour basis to monitor all aspects of the crisis. Similar working groups were soon established at the Department of Treasury and other governmental agencies. The principal policy arm of the President during this crisis was the National Security Council, working again through the Special Coordinating Committee. It was this body that coordinated the preparation of option papers and policy recommendations for the President.

An assets freeze was not among the policy options presented to the President in the first forty-eight hours after the taking of the Embassy. Faced with the Iranian refusal to return the Embassy and the hostages, President Carter decided initially to send two special envoys to Iran to meet with Ayatollah Khomeini seeking the release of the hostages and to discuss solutions to the serious problem between the two nations. This first effort was described as follows in the February 1981 State Department summary:

> The President selected former Attorney General Ramsey Clark, who had a long and close association with many of the new Iranian leaders and who had met with Khomeini in Paris early in 1979. Mr. Clark was accompanied by William Miller, Staff Director of the Senate Committee on Intelligence, who had served in Iran as a Foreign Service Officer in the 1950's and 1960's and who also knew the Iranian revolutionary leaders. The Iranian Government initially indicated that it would receive the Clark-Miller mission. However, as Mr. Clark was about to board a commercial flight from Istanbul to Tehran on November 7, he was informed that the Iranian Government had decided, on instruction from Ayatollah Khomeini, that he should not come to Iran and that no officials in Tehran should have discussions with American representatives.

During the early days of the hostage crisis the Carter Administration, through whatever avenues were available, appealed to all Amer-

icans to exercise restraint toward Iran and Iranian citizens in the U.S. and to do nothing that would endanger the lives of the hostages. The judgment was to make every effort to gain the release of the hostages through diplomatic means to avoid putting the hostages' lives in jeopardy.

The first public announcement of a specific action taken by the U.S. which was linked to the hostage issue came on November 10, 1979, when President Carter directed Attorney General Civiletti to identify any Iranian students in the United States who were failing to comply with the terms of their reentry visas and to commence deportation proceedings against those Iranian students who had violated immigration laws and regulations.

This politically symbolic action was soon followed by the first economic sanction. President Carter announced on November 12 the immediate discontinuance of United States oil imports from Iran. While reducing overall oil imports was a long-standing policy of the Carter Administration, the freezing of oil imports from Iran provided the chance to reemphasize our nation's vulnerability to imported oil and was an opportunity to stand firm against any threats or blackmail concerning our dependence on imported oil. However, the most significant part of the President's message dealt with the international political aspects of the Iranian actions:

> The lives of our people in Iran are at stake. I must emphasize the gravity of the situation. It's vital to the United States and to every other nation that the lives of diplomatic personnel and other citizens abroad be protected and that we refuse to permit the use of terrorism and the seizure and holding of hostages to impose political demands. No one should underestimate the resolve of the American Government and the American people in this matter.

These early political and economic decisions represented the type of immediate response that would demonstrate U.S. resolve, but they were not long-range sanctions intended to provide a crippling economic blow to Iran.

It is not the purpose of this report to discuss the military options that were available to President Carter; however, it is relevant to note that during the immediate post-hostage period, military options with economic significance such as a blockade of Iranian ports were under consideration. Non-military political and economic alternatives, which were always considered the preferable course, were the subject of detailed option papers during the November 10th to November 14th period.

What economic sanctions were available to President Carter, and why certain economic sanctions were selected and others avoided, are discussed in the paragraphs that follow.

Sanctions under the Trading with the Enemy Act were not seriously debated or considered because invoking that act would have required a declaration of war against Iran.

In the area of export control, once again, statutory prohibitions limited the options available. A total export embargo was a policy option that might have been seriously considered, but the Export Administration Act does not provide authority for a total embargo. Authority for a total economic embargo is contained in the Trading with the Enemy Act (the use of which was determined to be unaccept-

able) and the International Emergency Economic Powers Act. If a total export embargo was decided to be a proper course of action, then President Carter could only do so pursuant to IEEPA.

A limited export embargo on a specific commodity or commodities did not require the triggering of IEEPA. In order to impose such limited export controls, the President had to consider six very specific statutory tests under the Export Administration Act:

1. Take into account a series of prescribed "factors":

a. the probability that such controls will achieve the intended foreign policy purpose, in light of other factors, including the availability from other countries of the goods or technology proposed for such controls;

b. the compatibility of the proposed controls with the foreign policy objectives of the United States, including the effort to counter international terrorism, and with overall United States policy toward the country which is the proposed object of the controls;

c. the reaction of other countries to the imposition or expansion of such export controls by the United States;

d. the likely effects of the proposed controls on the export performance of the United States, on the competitive position of the United States in the international economy, on the international reputation of the United States as a supplier of goods and technology, and on individual United States companies and their employees and communities, including the effects of the controls on existing contracts;

e. the ability of the United States to enforce the proposed controls effectively; and

f. the foreign policy consequences of not imposing controls.

2. Determine that reasonable efforts have been made to achieve the purposes of the controls through negotiations or other means;

3. Consult with the Congress "in every possible instance";

4. "Immediately" notify the Congress and include with such notification a report specifying the President's conclusions with respect to each of the above six "factors", as well as the nature and results of any alternative means attempted or the reasons for imposing the control without attempting any such alternative means. (If the controls prohibit or curtail the sale of agricultural commodities, the Congress may, within 30 days of receipt of the report, adopt a concurrent resolution negating such controls);

5. Determine that adequate evidence has been presented demonstrating that the absence of such controls would prove detrimental to the foreign policy of the U.S. when placing controls on goods or technology determined to be available from sources outside the U.S. in significant quantities and comparable in quality to those produced in the U.S.; and

6 Take all feasible steps to initiate and conclude negotiations with appropriate foreign governments in order to secure their cooperation in controlling the export of goods or technology comparable to those items upon which the U.S. has imposed controls.

Export embargo options also required that before deciding on the scope of any foreign policy controls, it was necessary to consider the extent to which U.S. goods and technology used by foreign companies and U.S. foreign subsidiaries should be subject to controls.

This was an important point bearing on U.S. relations with third countries. It was also necessary to consider whether the controls would apply to all items produced by foreign subsidiaries of U.S. firms even if those items did not contain U.S. origin goods or technology. Any form of export control or embargo had a myriad of commercial and economic ramifications which were often broader than the purpose of the controls. Any controls imposed would have to allow sufficient flexibility to permit the Commerce Department to alleviate any unintended commercial or economic consequences without appearing to lessen U.S. resolve.

After considering the detailed procedural requirements for action under the Export Administration Act, which severely limited expedited application of export embargos and prohibited total export embargos, it became quite clear, based on the Department of Commerce analysis, that the best available tool to achieve full export impact on Iran was the Presidential triggering of IEEPA.

At the Department of Treasury, it did not take long to determine that the principal Presidential tool to implement total and unrestricted economic sanctions was IEEPA. The Treasury memoranda prepared in connection with the February 1979 deliberations at the time the Shah left Iran indicated some of the predisposition Treasury would have had toward invoking IEEPA. Even though the February crisis resulted in no decision to impose the sweeping provisions of IEEPA, which some in Treasury considered appropriate at that time, the mechanisms for quickly implementing IEEPA were ready and available. The legal memoranda and the draft regulations had been prepared and were ready for approval. Triggering IEEPA would put operational responsibility in Treasury, rather than in Commerce, State, or any other Executive department. All that was necessary for full implementation was a Presidential decision that existing circumstances constituted an "unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States."

President Carter made such a decision on November 14, 1979. The questions when the Administration actually concluded a freeze was necessary, and whether there was in fact an "unusual and extraordinary threat . . . to the national security, foreign policy, or economy of the United States" are discussed below.

President Carter triggered the provisions of IEEPA primarily in response to the barbaric political actions of the Iranian students and to endorsements of such actions by Ayatollah Khomeini and the revolutionary council. Such a triggering of IEEPA premised on the protection of the national security and the foreign policy of the United States was certainly consistent with the legislative history of that act. Such a non-military response to the actions of the Iranians was the only reasonable alternative and was appropriate to the domestic political pressures for Presidential action and the anticipated political reactions.

The decision to trigger an Iranian assets freeze was made on November 14, 1979 by President Carter at the recommendation of Secretary of the Treasury G. William Miller. Ostensibly, the freeze was ordered "in response to reports that the Government of Iran [was]

about to withdraw its funds" from the jurisdiction of the United States and that its purpose was "to ensure that claims on Iran by the United States and its citizens are provided for in an orderly manner." Secretary Miller advised President Carter that a key Iranian spokesman, Abol Hassan Bani-Sadr, had made a statement that Iran would repudiate all U.S. debts and precipitously withdraw all its funds from U.S. depository institutions. While there is no doubt that Bani-Sadr made such a statement, there is very serious doubt that if the Bani-Sadr statement were carried out to the fullest degree that the economy of the United States would have been subject to an unusual and extraordinary threat.

Longstanding and apparently universally accepted Department of the Treasury policy (previously discussed in this report in connection with the January–February 1979 crisis) directly contradicted the premise that withdrawal of Iranian deposits from U.S. financial institutions would jeopardize our U.S. financial system or pose an unusual or extraordinary threat to the economy of the United States. Similarly, Iranian threats to repudiate its U.S. obligations, which had been threatened by revolutionary figures on various occasions without result for as long as a year before the hostage crisis, was an unlikely event, and if consummated, not an unusual or extraordinary threat to the economy of the United States. Treasury memoranda written during the January–February 1979 crisis detailed the many forms of "self-help" available to U.S. corporations and in particular U.S. financial institutions. Discussions with the vast majority of the individuals involved in preparing the recommendations to President Carter to trigger IEEPA indicate that while outflows of Iranian dollars and Iranian debt repudiation were considered, the freeze was basically a political response to the barbaric acts of the Iranians. U.S. governmental statements concerning the freeze by President Carter, and in particular by Secretary Miller, attempt to lead one to conclude that a primary justification for the freeze was the threat to the U.S. economy by Iranian repudiation of U.S. debt and the withdrawal of Iranian funds from U.S. financial institutions.

If, in fact, the freeze was truly a political response to the severity of the Iranian actions, which constituted an unusual or extraordinary threat to the national security and foreign policy of the United States, then, why was there so much public emphasis put on the economic ramifications of Iran's actions? It is our opinion that the Carter Administration was in the process of implementing the freeze before Bani-Sadr made his threat to withdraw Iranian funds from U.S. banks. The Bani-Sadr threat added an economic justification—however weak its premise—to the actual political justification which prompted the freeze. The added economic justification became important because of the reaction to the freeze by others, primarily OPEC countries.

The Carter Administration went to great lengths to prop up this questionable economic justification for the freeze. There was a realization that other OPEC countries might have to fear for their deposits if the U.S. were willing to invoke a freeze for "political" reasons against them. The Administration did their best to reassure Saudi Arabia and other countries that this would not happen to them, and put increasing emphasis on the economic reasons for the freeze. It must be remembered that during this period of time, other OPEC nations,

and in particular Saudi Arabia, were under similar internal religious pressures which made their endorsement of a U.S. freeze based on political grounds practically impossible. However, if these Arab-OPEC nations could avoid emphasis on the politics of the freeze and support (or at least tolerate) the freeze premised on economic reasons, then they were on safer internal political ground. The Finance Ministers of Saudi Arabia and Kuwait could then stress that the U.S.-Iranian assets freeze was taken in an effort to preserve the value of the dollar and the U.S. economy, an economy in which both of those countries had made major investments.

A battered dollar or weakened U.S. economy would therefore be a serious blow to these Arab-OPEC nations. It is under these circumstances that Carter Administration spokesmen consistently avoided discussing a political freeze and instead emphasized the economic aspects of a freeze.

Besides analyzing the rationale for the implementation of the freeze, it is also important to examine the range of options pertaining to the types of Iranian assets to be blocked. The option papers presented to the National Security Council's SCC provided four choices, of which the most significant aspect was the extraterritoriality of the freeze. In other words, the U.S. could decide, as it ultimately did, to impose an assets freeze on the deposits of foreign branches or subsidiaries of U.S. commercial banks. While such an extraterritorial freeze was both politically and legally risky, any freeze that did not include deposits in the foreign branches or subsidiaries of U.S. banks would have been a complete failure. It was by freezing these foreign deposits that the great portion of the Iranian assets were blocked. The reasons for a freeze, the type of a freeze, and when and how a freeze was to be implemented are extremely complicated. What is important to note is that for historical purposes these reasons must be analyzed in order for the Congress to accurately understand its consultative and oversight role pursuant to the provisions of IEEPA.

II. THE REGULATORY EFFORT

While many of the newspaper accounts of President Carter's order freezing Iranian assets tend to talk about the "freeze" as an isolated action, in fact, the November 14, 1979 Executive Order (No. 12170) freezing Iranian assets initiated a significant year long regulatory effort at the Department of Treasury. This section describes the freeze orders and the implementing regulations.

In addition to blocking property of the Iranian government, its instrumentalities and controlled entities and the Bank Markazi (Iran's central bank), E.O. 12170 authorized the Secretary of the Treasury to use the powers of the International Emergency Economic Powers Act (IEEPA) to carry out the order. The next day, November 15, the Department of the Treasury issued the first of a series of regulations imposing restrictions on Iran and licensing certain actions by entities affected by the freeze. In some respects the Iranian assets control regulations (published at 31 CFR Part 535) differed from previous regulations issued by Treasury that have applied to other nations whose assets had been frozen. Given the unique circumstances of the Iranian situation, Treasury decided not to apply these previous regulations to Iran's assets but rather to issue its Iranian rulings over an extended period of months. The first bare bones regulations of November 15 relating to the Iranian freeze did little more than establish the basic prohibition on transactions in frozen assets, define certain critical terms, and set up an enforcement mechanism. These initial regulations also authorized payment of certain checks and drafts and completion of securities transactions that were made before the freeze took effect. Subsequently, Treasury issued regulations on the following matters (dates in parentheses indicate the publication date in the Federal Register):

1. Allowing set-offs of U.S. bank claims held overseas against blocked overseas deposits (Nov. 16).
2. Allowing payments by Iran on obligations owed to U.S. persons to be transferred and distributed through U.S. banks, as long as a blocked account was not debited (Nov. 20, Nov. 26). Exports to Iran either licensed by the Commerce Department or that involved blocked properties such as medical supplies, clothing, and educational materials were also authorized (Nov. 20).
3. Authorizing payments to blocked accounts in the U.S., including payments from foreign branches of U.S. banks (Nov. 20).
4. Forbidding transfers from domestic to foreign branches (Nov. 26).
5. Establishing licensing and unblocking procedures and unfreezing foreign non-dollar accounts (Nov. 21).
6. Authorizing judicial proceedings (such as attachment actions) against Iranian property, although judgments or other decrees were not permitted and blocked funds could not be used to pay for judicial judgments (Nov. 26, Dec. 4).

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7. Authorizing certain payments under letters of credit drawn on U.S. banks. Companies involved in standby letters of credit were allowed to open blocked accounts on their books when Iran demanded payment (Dec. 3, Dec. 19, Jan. 9).

8. Authorizing transfer of funds from demand deposits to interest-bearing status at an Iranian depositor's instruction. Unlicensed extensions of new or renewed credit to Iran after Nov. 14 were prohibited (Dec. 28).

The flow of regulations tapered off during the period of January–April 1980 until President Carter imposed new economic sanctions on Iran. On April 7, citing the earlier freeze and the continuing economic threat posed by Iran's lack of recognition of the World Court and United Nations actions, President Carter issued Executive Order 12205 which included the following:

1. The blocking of all commerce between the U.S. and Iranian entities or persons (excluding foreign subsidiaries of U.S. companies), except for food, medicine and other medical supplies and clothing donations, and transportation connected with that commerce;

2. Prohibitions on banks making new loans to Iran, letting Iran significantly increase its non-dollar bank deposits, and on banks "failing to act in a businesslike manner" (e.g., failing to employ the usual remedies with respect to Iran's failure to make timely loan payments);

3. Barring U.S. entities from entering new service contracts for industrial projects in Iran.

On April 17, President Carter took further actions, citing the Soviet occupation of Afghanistan in addition to the reasons announced on April 7. Executive Order 12211 added these new sanctions:

1. Prohibited direct or indirect imports of goods or services from Iran.

2. Forbade transactions with foreigners regarding travel to Iran.

3. Barred payments by or on behalf of Americans in Iran of expenses for transactions in Iran.

4. Prohibited any payments or other asset transfers to Iran, except for family remittances. (News gathering activities were exempted from these first four sanctions).

5. Revoked all licenses for transactions with Iran Air, National Iranian Oil Company and National Iranian Gas Company.

6. Undelivered defense articles, delivery on which was suspended in November 1979, were to be converted to U.S. government use or transferred to other buyers.

The Treasury Department issued a series of regulations in April and May to carry out these new Executive Orders. Many of these new regulations simply paraphrased the terms of the Executive Orders.

On April 9, 1980, Treasury published a very significant requirement, commonly known as the census, which mandated the filing of reports by American entities and persons on Iranian assets and claims. Responses were required by May 15, 1980. This census was intended to become a comprehensive source of the exact financial relationship each U.S. bank had with Iran. Unfortunately, the census never yielded the type of accurate data that would reflect the actual position of

each financial institution precisely enough for use during the final detailed settlement negotiations. The numbers constantly fluctuated, and though the variations usually involved relatively small sums, they made the census unreliable. In addition, the office in Treasury which updated the numbers was not the office which originally gathered the information.

In December 1980, when negotiations with the Iranians appeared to be approaching resolution, the U.S. banks involved in syndicated loans developed their own set of numbers with the help of Peat, Marwick, Mitchell and Co. Similarly, the government, with cooperation from the Federal Reserve Bank of New York, again surveyed the banks seeking a more accurate listing of the Iranian deposits and loans.

We cannot assess whether the inadequacies of the census are the responsibility of the Department of Treasury, which compiled the census, or of the banks responding to the census. However, we can state that there were serious problems with the methods used by the Department of Treasury to gather precise statistical information throughout the course of the freeze.

A General Accounting Office report prepared during the freeze and issued on November 14, 1980 criticized the efficiency of Treasury's Office of Foreign Assets Control. GAO criticized the Treasury Department's inability to maintain control over blocked assets in carrying out a number of freezes involving countries other than Iran, as well as the most recent effort in Iran. The committee staff has found that many of the reforms suggested by GAO had been previously proposed internally within the FAC office and now have been implemented under the office's new Director, Dennis O'Connell. Given its modest staff resources, the office worked under extremely difficult circumstances in gathering the complicated statistics and administering the licensing program under the freeze.

In addition to the difficulties encountered in gathering and reporting statistical data for purposes of the census, many of the compliance problems faced by banks after the imposition of the freeze were resolved either through general licenses issued in the Treasury regulations, or through specific licenses granted to individual banks. One of the first of the general licenses authorized by Treasury involved set-offs, which are actions taken by banks to reduce their deposit liability to Iran by the amount of the Iranian assets they held. Treasury authorized set-offs against foreign deposits on November 16, 1979, a decision that resolved early questions about whether set-offs would be allowed, particularly against unmatured debt. Within a few days after the freeze, Treasury regulations answered other questions. The issues dealt with in these regulations included whether non-dollar deposits overseas would be subject to the freeze; whether Iran could pay its obligations out of unblocked funds; and whether deposits could be transferred between foreign and domestic accounts.

One major question that was never resolved by final regulation was whether banks were obligated to put Iranian funds in interest-bearing accounts. Treasury's Foreign Funds Control Regulations, which governed previous blocking actions but did not apply to the Iranian freeze, had been revised in March 1979 to require that blocked

funds subject to those regulations be held in interest-bearing accounts. Treasury did not even propose a rule to impose a similar requirement for Iranian funds until July 1980, eight months after the hostages were taken. Apparently Treasury decided to postpone the requirement for interest-bearing deposits in the Iranian situation for many reasons. Among them was the belief that doing anything favorable to Iran in those emotionally-charged weeks just after the hostages were taken might precipitate adverse public reaction in the U.S. Requiring interest also might give the freeze an appearance of permanence that was contrary to the U.S. desire for a quick end to the crisis. An indication of Treasury's reluctance to address directly the interest issue was the authorization in late December 1979, for banks to honor Iranian requests to transfer funds from demand deposit to interest-bearing accounts. Although some banks, by previous agreement with Iranian depositors, already held funds in interest-bearing accounts, there is significant evidence that Iranian depositors did not take advantage of this December 1979, authority to shift noninterest-bearing demand deposits to accounts bearing interest.

The U.S. Government considered the interest-bearing account authorization a bargaining chip, or a potential signal for use in negotiations with Iran. By July 1980, the situation had calmed enough that Treasury issued a proposed rule that would have required U.S. banks to place Iran's frozen funds in interest-bearing accounts. Because of its potential to be a landmine of technical problems and because of the anticipated adverse reaction by the banking community, this rule was put out for public comment, even though none of the other Iranian freeze regulations was issued for comment in proposed form. The proposed regulation required interest to be credited beginning on December 1, 1979. The proposal did not require interest payments to the extent valid set-offs would have been imposed on Iranian deposits absent the freeze. Assets held in foreign branches of U.S. banks were exempted from the regulation, although they could be subject to payment of interest under the host country's law. The regulation proposed a rate of interest of not less than 5½ percent, and for amounts of $100,000 or more the rate would be that payable on 30-day certificates of deposits as specified by the Federal Reserve Board.

Bankers' comments on the proposed rule varied greatly. The Riggs Bank perceived a Fifth Amendment violation in the proposed regulation, and urged that Iranian deposits be treated no more favorably than American deposits. Bankers Trust contended that it was

> highly inequitable and inappropriate for the Department of the Treasury . . . to shift the burden of [the bank's costs in administering the freeze] from the Iranian governmental entities, whose illegal acts gave rise to the Regulations, to the shareholders of the Bank, who are in large part U.S. citizens.

Other banks opposing the regulation took a cautious approach. European American Bank, through its counsel Sullivan and Cromwell, argued that "Temporization is also suggested by the eruptive unpredictability of events." Manufacturers Hanover Trust urged that its negative views be treated confidentially by the government, apparently unaware that all comments were to be put in a public docket.

The views of the First National Bank of Chicago perhaps epitomized

the more substantive comments of banks that opposed paying retroactive interest on Iran's demand deposits:

> The financial relationships between Iranian depositors and U.S. banks originally contemplated that a portion of the depositor's funds would be held in demand accounts. The holding of such funds as demand deposits was to help defray the expense of day-to-day transactions and investigations thereof with respect to such accounts. While transactions using these accounts have ceased, investigations of past transactions have not . . . Investigations have increased as a result of the present instability in Iran, and, as a consequence, the expense of processing them has also increased. Therefore, we believe that demand deposits of Iranian depositors should be left as such to help defray the actual and relatively high expense of dealing with these accounts.
>
> In any event, the Regulations currently allow Iranian entities to request transfers of their deposits from demand to interest-bearing accounts. 31 CFR 535.420. If the Iranian depositors have chosen not to make such a transfer, their presumed preference should be followed.
>
> FNBC recognizes that it is possible that in certain cases demand accounts may have been frozen at an artificial "high" and that it would be inequitable to retain the entire amount in a demand account. In such cases, it might be appropriate, for example, to limit the amount of the demand account to the average account balance over the last six months. In this manner, only the normal demand balance is retained and the banks do not derive unjust enrichment from having an artificially high demand balance.

First Chicago denied that U.S. banks were reaping a windfall profit from the freeze, because of the expenses involved in maintaining the deposits. Other banks, however, strongly argued the other way, and attacked their banking brethren that were fortunate enough to hold Iranian deposits. In praising Treasury's proposed regulations, First National Bank in Dallas said:

> We believe [the proposed interest regulation] would achieve increases in the value of the blocked property during the freeze in accordance with customary financial practices, thus ensuring that the earning potential of such property is made available to its ultimate recipients, rather than solely to those who presently hold it.

United Virginia Bank used more expressive language to support the regulation. This bank argued that it was suffering competitive injury under the freeze:

> [The proposed regulation] ensures that the earning potential of such assets is made available to the ultimate beneficiaries of such assets, whomever they may turn out to be, rather than being available solely to those entities which fortuitously hold such blocked assets. Furthermore, the Regulation ensures that the interest-earning potential of such blocked assets is not inequitably reaped only by the holders of such assets.
>
> We believe that the Regulation properly reflects the interest value of money, which is of utmost importance when interest rates and inflation reach the levels they have recently. For this reason, it is especially appropriate that the Regulation is effective from December 1, 1979. Although those institutions which have benefitted from the substantial windfall of having free use of blocked assets since the date of the freeze may object to this effective date, such objection would be ill-founded and disingenuous since such institutions will have had the benefit of these assets and received the earnings therefrom during the entire period of the Iranian asset freeze.
>
> For the foregoing reasons, UVB commends the Department of the Treasury for being so sensitive to this important matter and strongly urges the final adoption of the Regulation.

United Virginia obviously held loans from Iran but no deposits on which it would have to pay interest. United Virginia's approval of the goal of the Treasury regulation was perhaps exceeded only by that of Security Pacific Bank, which urged Treasury to go even further by

applying interest to foreign as well as domestic accounts, pushing the retroactivity date back even further to November 14, 1979, and requiring the payment of compound rather than simple interest.

The interest regulations were in final form by September 1980. However, by that time there had been some movement on the negotiating front and nothing was done to issue the regulations out of concern for their impact on the Iranian's willingness to negotiate. Deposit interest could then have become a positive signal to Iran, but the U.S. continued to hold deposit interest as a negotiating card until the hostage crisis was finally resolved. The banks affected by the regulation were on notice from July, when the proposed rule was issued, that interest, calculated from a date close to the beginning of the Iran crisis, would likely be part of the final settlement. Finally, while Treasury might be criticized from the standpoint of regulatory efficiency for failing to resolve quickly the deposit interest issue, Treasury's seemingly inexplicable unwillingness to follow precedents from its other Foreign Asset Control regulations regarding interest on deposits becomes more comprehensive in light of that issue's perceived value in the complex negotiations with Iran.

III. THE FORMAL NEGOTIATIONS

It took three days to get a quorum, but on November 2, 1980, the Iranian Majlis (Parliament) met and concluded its debate on the American hostage problem. Three hundred and sixty-three days after the storming of the American Embassy and the taking of the hostages, the Majlis laid down the four conditions for the hostages' release which were to become the framework of the final resolution of the hostage situation. The conditions were: (1) a pledge of noninterference in Iranian affairs; (2) release of frozen assets; (3) cancellation of all sanctions and U.S. claims against Iran; and (4) return to Iran of the assets of the Shah and his close relatives. During the next two and one-half months the U.S. government and Iranian negotiators worked through Algerian intermediaries to refine and develop the technical mechanisms required to bring about the hostage release and financial settlement. The principles enunciated by the Majlis on November 2, 1980, remained the framework of the final agreement.

During the preceding year, there was virtually no Iranian movement on the hostage issue. In contrast, the Carter Administration pursued virtually every reasonable path toward resolution of the hostage problem: the U.N. Security Council; the International Court of Justice; the U.N. Secretary General; and pressure from other governments. The U.S. from time to time dealt with Argentine businessmen, French lawyers, former U.S. Attorneys General, and the Palestine Liberation Organization in an effort to communicate with elements in Iran. Some avenues raised hopes but they were dashed at the end. What, then, were the circumstances that finally led Iran to begin to seek actively a settlement to the hostage problem in early November?

In the months preceding November, 1980, a number of factors began to create a financial incentive and the political will to end the crisis. For the first time since the February 1979 Iranian Revolution, a permanent political structure seemed to be in place. The Majlis, which had been charged by Ayatollah Khomeini with the responsibility for establishing terms of the hostage release, convened on May 28, 1980. Soon thereafter the Majlis selected Ali Akbar Hashemi Rafsanjani to serve as Speaker, and Mohammed Ali Rajai was chosen as Prime Minister on August 11, 1980.

With the installation of the parliament, the Prime Minister, and his cabinet, the political lines of authority became much clearer and the U.S. directed a flurry of diplomatic activity at the new government of Iran. A group of 187 members of the U.S. Congress wrote to Speaker Rafsanjani in August asking that the hostage issue be given top priority. In mid-August a group of eleven ambassadors to Iran from other developed countries petitioned Speaker Rafsanjani for the release of the hostages. The hostage families sent a letter to Speaker Rafsanjani on September 13, asking for release on humanitarian grounds. Similarily, Secretary of State Muskie wrote to Prime Minister Rajai

on August 31 and again on September 30 appealing for the release of the hostages and calling for a new era in Iran-U.S. relations.

In Iran, other factors besides the establishment of a recognizable political institutional structure made the resolution of the hostage matter a priority. The U.S.-imposed economic sanctions, which Iranian leaders had previously claimed were ineffective, had begun to take their toll. In early August President Bani-Sadr conceded to a West German reporter that the U.S. economic sanctions had raised the price of Iranian imports by 20–25%. To many Iranians it had now become apparent that the economic and international political price Iran was paying for holding the hostages had begun to outweigh whatever domestic political gains the taking of the hostages had brought.

As these political and economic factors coalesced in Tehran, positive signs for the U.S. were developing on the diplomatic front. In September, the U.S., with the help of the West Germans, found its best intermediary to that time. The West German Foreign Ministry informed the U.S. that Sadegh Tabatabai, a brother-in-law of Ayatollah Khomeini's son, was prepared to undertake exploratory talks with the U.S. Government. Earlier in 1980, Tabatabai had been involved in discussions concerning the hostages with the West Germans, but the attempted U.S. rescue mission in April had ended those conversations. Now, in September, Tabatabai once again agreed to begin discussions. The U.S. government, however, remained skeptical. Questions remained whether Tabatabai was keyed in to the proper sources in Tehran. It was soon dramatically demonstrated that the Tabatabai sources were legitimate. Tabatabai described, in advance, the same four conditions for the release of the hostages that Ayatollah Khomeini would outline in a September 12 speech. Reassured, the U.S. quickly set up a working group of State Department, Treasury, Justice, and National Security Council officials to develop a formal negotiating position. The mid-September initial contact in West Germany with Tabatabai seemed promising, but once again a major impediment to the Tabatabai discussion occurred. The Iraqi invasion of Iran on September 22 postponed the discussions, which were never seriously reinstituted.

Ayatollah Khomeini's September 12, 1980 statement, as promised by Tabatabai, was his first pronouncement setting forth conditions for the release of the hostages since his November 6, 1979 endorsement of the Iranian student demands for the return of the Shah and his wealth. As part of a wide-ranging speech, Khomeini announced that the Majlis would decide the course of action for the hostages, and that the conditions of release should be: return of the frozen assets; return of the property taken illegally by the Shah; cancellation of financial claims against Iran; and a pledge not to interfere in Iran's internal affairs. The Majlis debate on the hostage issue had been scheduled for the following day, September 13, but because of the beginning of border skirmishes with Iraq, other matters took priority within the Majlis.

While the short-run effect of the Iraq-Iran conflict was to divert attention away from the hostage issue, many former officials of the Carter Administration are convinced that the Iraqi war brought considerable additional pressure on Iran to settle the hostage matter. The lack of diplomatic support of its position pertaining to the Iraqi invasion

intensified Iran's sense of diplomatic isolation. Fighting a war with disrupted oil supplies and its U.S.-held assets frozen required a drawdown of already diminished reserves and placed the Iranian leaders in a position from which they had no alternative but to address the hostage issue.

When the Ayatollah Khomeini reaffirmed his conditions on the hostages in a speech on October 3, other Iranian government officials followed suit. On October 11 President Bani-Sadr stated that conditions were soon to be presented to the U.S. which it could accept or reject without negotiation. On October 13 Prime Minister Rajai said that it was in Iran's best interest to resolve the hostage problem but resolution depended on the U.S. The following day, Supreme Court head (and leader of the Islamic Republic Party) Ayatollah Beheshti said the hostage problem should be resolved quickly.

With the Majlis decision on November 2 to set forth the four conditions for release (as announced by Ayatollah Khomeini on September 12), real negotiations between the U.S. and Iran became possible for the first time. The Majlis Resolution stated the conditions that the United States:

pledge not to interfere in the affairs of Iran;

lift the freeze on Iranian assets and put all these assets at the disposal of Iran;

cancel all economic and financial sanctions against Iran, cancel all U.S. claims against Iran, and assume financial responsibility for any claims made against Iran;

return to Iran the assets of the Shah and his close relatives.

In return, Iran would gradually release the hostages as the U.S. implemented the stipulated conditions. If the U.S. did not meet Iranian demands, the hostages would be brought to trial.

President Carter received the Majlis decision as a proposal offering a positive basis for resolution of the crisis. On November 3, Deputy Secretary of State Warren Christopher and a small group of advisors began to formulate a U.S. response. Members of the group included Assistant Secretary of State for Near Eastern Affairs Harold Saunders, Legal Adviser Roberts Owen and Deputy Secretary of Treasury Robert Carswell. On the same day, in Iran, Prime Minister Rajai formally requested the assistance of the Algerians to act as intermediaries and announced that Algeria would be the sole contact for communications between Iran and the U.S. on the hostage issue. Prime Minister Rajai ordered a committee to be established under Minister of State Nabavi to deal with the hostage problem and the negotiations with the United States.

In the U.S., during the November 3 election week, the working group under Deputy Secretary Christopher continued to develop a response to the Majlis conditions. The election of Ronald Reagan as President of the United States caused Iranian spokesmen for Prime Minister Rajai to state that the U.S. elections would have no bearing on the resolution of the hostage issue.

On November 7, the State Department announced that it was close to reaching a decision on a response to Iran's four conditions. On November 10, Deputy Secretary Christopher and the members of his working group departed for Algiers to present personally the detailed U.S. position. Deputy Secretary Christopher informed the Algerians

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that the U.S. could accept the Majlis resolution as a basis for ending the crisis but that the U.S. executive was constrained by the United States Constitution and the U.S. legal system in several important respects. Christopher also made it clear that any solution must reflect U.S. national interests and national honor and be viewed as equitable to both countries. The U.S. response embodied a general discussion on each of the four points in the Majlis resolution. The U.S. proposed a series of Presidential Orders, to be effective on release of the hostages, stating that:

1. U.S. policy is to refrain from interfering, directly or indirectly, politically or militarily, in the internal affairs of Iran.

2. All capital and assets of Iran in the jurisdiction of the U.S., either here or abroad, would be unblocked, to allow the two countries to move expeditiously toward a resumption of normal financial relations as they existed before November 14, 1979. Iranian assets in the Federal Reserve Bank of New York would be available to Iran, and U.S. legal restrictions would be removed from Iranian assets in foreign branches of U.S. banks. The U.S would join Iran in a claims settlement procedure to permit cancellation of judicial orders and attachments relating to Iran's assets under U.S. jurisdiction.

3. All economic and financial sanctions imposed by the U.S. relating to exports to, imports from and transactions with Iran would be revoked, and the U.S. would drop any claims before the International Court of Justice or potential claims for damages based on the hostage seizure.

4. The U.S. would prohibit the transfer from the U.S. of any properties owned by or derived from the Shah's estate. In addition, the U.S. would assist in collecting information identifying the Shah's property in the U.S. and would, in any U.S. court actions pursued by Iran, assert through the U.S. Attorney General that Iran has standing to enforce its judgments in U.S. courts under U.S. law and that Iran's legal action should not be barred by the sovereign immunity or act of state doctrines.

On November 12, the Algerian team (including Ambassador to the U.S. Redha Malek, Ambassador to Iran Gheraieb and Chairman of the Algerian Central Bank Mostefai) flew to Tehran where they would remain for the next ten days explaining the latest U.S. position to the Iranian negotiating committee headed by Minister of State Nabavi. In separate statements on November 19 and November 20, Speaker Rafsanjani announced and Secretary Muskie confirmed that the U.S. had accepted in principle the Majlis conditions as a basis for resolution of the crisis. Soon thereafter, the Iranians requested additional information on the pending U.S. litigation against Iran; an inventory of Iranian assets held by U.S. banks and set-offs taken by those banks; and other financial and legal data. In a second Iranian statement on November 26, the U.S. position was criticized for containing "new proposals" and for being "obscure." Iran seemed to want a clear and concise response to each of the specific points raised in the Majlis resolution of November 2.

The Christopher group worked through the end of November to reshape the U.S. position into the format desired by Iran. On December 2, the group returned to Algiers with a modified U.S. plan and

with working papers outlining various scenarios as to how the "undertakings" could be carried out. On December 4, the Algerians presented to the Minister of State Nabavi and his negotiating committee the five-page U.S. clarification.

Over the next two weeks, public and private reactions from Iran were very positive. Speaker Rafsanjani and Negotiator Nabavi indicated that substantial progress had been made and only a few technical details remained to be worked out. However, on December 19, the hope for a pre-Christmas release of the hostages was crushed when the Iranians demanded that nearly $24 billion be deposited with the Algerians prior to any release of the hostages. By U.S. government calculations, the $24 billion demand was three times the amount of Iranians assets on deposit with U.S. financial institutions in the U.S. and abroad. The Iranians referred to the $24 billion as financial guarantees, and apparently this nearly $24 billion included over $9 billion to cover known Iranian assets in U.S. financial institutions, $10 billion as security for return of the Shah's assets, and an additional $4 billion to cover any other Iranian assets which might later be discovered.

This unanticipated and inflated Iranian demand and the extremely unfavorable U.S. government reaction heightened the level of rhetoric. U.S. officials called the Iranian demand unacceptable. President-elect Reagan referred to the Iranian demand as ransom and called the Iranians "barbarians." Speaker Rafsanjani threatened to put the hostages on trial if the U.S. did not agree to the Iranian conditions.

Despite the seemingly dim prospects of reaching agreement before the end of the Carter Administration's term of office, Deputy Secretary Christopher convened his working group to make one final attempt at drafting terms of agreement which reflected the new Iranian demands. While the group viewed the Iranian demand for $24 billion as a step backward, there were certain positive elements in the new proposal. The Iranians had agreed to make current all payments on outstanding loans to U.S. financial institutions and to settle any other disputed claims against Iran through some form of arbitration.

On December 28, 1980, the Iranian news agency Pars published a text which it claimed was the U.S. government position which had been made public by Prime Minister Rajai. Pars also published Rajai's comments on that text. On the following day, to avoid any possible confusion, the State Department released the official U.S. government proposal. On December 30, Iranian negotiator Nabavi announced that Iran would accept whatever settlement on financial guarantees Algeria was able to work out with the U.S.

Also on December 30 the U.S. presented the revised U.S. response to the Algerian intermediaries. This response contained all the elements eventually incorporated in the final agreement. The U.S. proposal contained two basic elements: (1) a claims settlement procedure which involved an arbitration panel (Iran was to establish a "Security Account" in a neutral central bank out of which it would pay any claims); and (2) the establishment of escrow accounts in a neutral central bank into which frozen Iranian assets would be deposited once the Algerians certified that the hostages had been freed and were out of Iranian air space. Both proposals would be presented in the

form of a declaration of the Algerian government which both Iran and the U.S. would agree to and sign.

The U.S. negotiators took pains to explain to the Iranians, though the Algerians, that the process of petitioning U.S. courts to lift attachment orders against Iranian assets would be a time-consuming process that could not be completed simultaneous with the release of the hostages. In addition, U.S. officials sought to put some time pressures on the Iranian government by stating it would not be possible to work out all the complicated arrangements before January 20, unless the Iranian government agreed to the proposals by January 16. At the same time, the U.S. made minor changes in the language pledging U.S. non-intervention in Iranian affairs and a return of the Shah's assets; however, according to U.S. officials, these points no longer appeared to be issues of contention.

The Iranian reaction to the U.S. proposals was positive. Sensing a breakthrough, Deputy Secretary Christopher and the members of the working group flew to Algeria on January 7 for direct negotiations with the Algerian intermediaries, talks which were impossible if the U.S. group remained in Washington. At this point the private talks which had been taking place between Iranian central bank officials and representatives of U.S. commercial banks merged with the official government negotiations. As it became apparent that a settlement of the financial issues required banking expertise, throughout the week of January 12th U.S. bankers worked with U.S. government representatives in London drafting some of the detailed documents necessary to carry out the financial transactions. During the same period of time, Robert Mundheim representing the Treasury Department and Ernest Patrikis representing the New York Fed, had a series of discussions with the Bank of England and the West German Bundesbank to determine which one of those central banks would act as depository for the Algerian escrow accounts into which Iran's deposits from U.S. banks would flow. During the week of January 12th the U.S. decided to engage the Bank of England as escrow agent. This decision was based on the conclusion that the law of the United Kingdom was more hospitable than the law of West Germany, and was less likely to permit successful legal challenges to the orderly transfer of Iranian assets.

On January 15, at the request of Warren Christopher, two high ranking Bank of England officials were asked to immediately come to Algiers, because the Algerian intermediaries wanted to consummate the final settlement in Algeria. Joining the Bank of England officials on the January 16 early morning flight were Patrikis, Mundheim and two American bank lawyers, Thorne Corse from Bank of America, and Frank Logan, outside counsel for Chase Manhattan Bank. These lawyers had been asked to come to Algiers and be available to the U.S. diplomatic team.

Deputy Secretary Christopher asked the financial negotiators to come to Algiers so that the financial settlement could be completed in the same physical location as the other negotiations. Deputy Secretary of the Treasury Carswell decided which of the private bank lawyers in London would accompany the financial negotiators to Algiers. In Mr. Logan's case the choice was dictated by Logan's drafting skills and the fact that he had been an early participant in the Hoffman

negotiations, and Mr. Corse was chosen because he represented the financial institution most affected by the final agreement. The two bank lawyers served as a link to the other bankers and bank lawyers who were standing by in London, New York and Washington, available for consultation if last-minute problems arose which required a U.S. bank reaction or drafting assistance.

Once in Algiers, Mundheim and Patrikis concentrated their efforts on the drafting of the financial documents, some of which had to be redrafted in view of the Iranians' January 15 decision to pay off their bank loans rather than simply pay enough to bring those loans up-to-date as of the effective date of the settlement agreement. The two bank lawyers, Logan and Corse, were available to assist in the drafting and proofreading efforts, but at no time did they take part in the formal negotiating sessions with the Algerians.

The many problems that arose in Algiers over the last few days before the hostages' release are described in the section of this paper dealing with the role of the Federal Reserve, and are not repeated here. For a more detailed chronology of the formal negotiations, a document entitled "The Hostage Crisis in Iran: 1979–1981" provides valuable information on how the settlement evolved. This 59-page paper, prepared in the State Department during the Carter Administration, was submitted by former Assistant Secretary of State Harold Saunders to the House Foreign Affairs Committee during hearings in February, 1981. Other useful information on the negotiating effort is contained in the testimony of former Secretary of State Muskie, Deputy Secretary Christopher and Assistant Secretary Saunders before the Senate Foreign Relations and House Foreign Affairs Committees, and the testimony of former Deputy Treasury Secretary Robert Carswell and State Department Legal Adviser Roberts Owen before the Senate Banking Committee.

IV. THE INFORMAL BANK NEGOTIATIONS

Immediately after the specifics of the January 20th hostage settlement agreement were made public, critics attacked the agreements for what they claimed was the preferential treatment given U.S. commercial banks over other claimants. Indeed, some alleged that the banks used the negotiating process to set themselves up for a full payoff of what were otherwise questionable Iranian loans. Others contended that the economic and political power of the U.S. banks allowed them to dictate an agreement consciously benefiting U.S. banks to the detriment of other U.S. non-bank commercial interests.

Undoubtedly, one of the reasons for these charges was that at least some of the major U.S. banks were carrying on informal and secret discussions with intermediaries for the Iranian central bank—Bank Markazi—as early as May 1980. The nature of those discussions, veiled as they were in a cloak of mystery and replete with tales of secret trans-Atlantic flights and ultraprivate negotiations, provided a setting ripe for theories alleging that the U.S. banking community used its powers to negotiate a sweetheart deal for itself with Iran. In fact, as the details of the informal bank negotiations were discovered, it was found that the informal bank negotiations were no legal or financial honeymoon. They were, instead, negotiations filled with frustrations, with hopeful starts followed by depressing delays, and without certainty that agreement was possible or that the parties apparently acting on behalf of Iran were, in fact, able to deliver on their promises. There are practical reasons to explain why one U.S. bank was able to carry on a more intensive series of negotiations than the others, even though Iran's intermediaries approached more than one U.S. bank with apparent offers to discuss conditions for settlement of financial matters. This is discussed in more detail below.

All of the U.S. banks that held Iranian assets or had made loans to Iran were acutely aware that the November 1979 freeze had significant consequences for them. The President's order froze some $6.8 billion in Iranian deposits in domestic and foreign branches of U.S. banks. Some banks immediately took advantage of the Treasury Department's authorization to set-off their loans against Iran's deposits in the foreign branches of U.S. banks. The U.S. banks' domestic deposits were subject to a deluge of attachment suits by Iran's creditors, and some banks also had letters of credit outstanding and other instruments payable to Iran's account. With so much at stake and with a myriad of lawsuits and countersuits filed, the U.S. banks, in consultation with their lawyers, began to consider how this complicated financial picture might be resolved. For experienced bank lawyers there was also the painful recollection that litigation to resolve the Cuban and Chinese blockings of relatively modest sums had dragged on for decades.

John Hoffman, a partner in the law firm of Shearman and Sterling and Citibank's outside counsel, and Hans Angermueller, Citibank's

Senior Executive Vice President, were among those who began contingency planning shortly after the November freeze. While their discussions were probably no different from similar considerations throughout U.S. financial centers, the two Citibank officials apparently went further than most of their peers and developed a very rough prototype of an overall settlement that came to be called Plan A. Under Plan A, which was never formally reduced to writing, Iran's dollar debt to each of the U.S. banks would be paid off, in return for the removal of the freeze and the release of the hostages. Non-bank claims would be bonded or collateralized pending subsequent resolution through an arbitration mechanism.

In the early months of 1980, the Treasury Department began a series of meetings with U.S. businesses involved in Iran. In February 1980 Citibank was invited to one of these meetings with Treasury and State Department representatives, at which Mr. Hoffman outlined the concepts (Plan A, and its more detailed progeny Plan B) that Citibank was considering. At the time, these Hoffman plans were nothing more than general thoughts by one affected party. They were not adopted in any sense by the U.S. Government, whose own lines of diplomatic communication with Iran were tenuous at best at that time.

In May 1980, a reasonable forum developed for discussing these Hoffman settlement ideas with intermediaries for Iran. The occasion for these discussions was the extensive European litigation relating to frozen Iranian assets in the European branches of the U.S. banks. Following the November freeze, and the bank set-offs imposed soon thereafter, Iran sued a number of large New York banks in several countries, including England, France and West Germany. Iran claimed, among other things, that the freeze and set-offs were illegal, at least regarding Iranian assets held outside the U.S.

As this litigation proceeded, Iran's West German lawyers on May 2, 1980 approached Citibank's lawyers signaling interest in discussing a resolution to the U.S. bank-Iran situation. Citibank was, in a sense, a natural target for these inquiries, because litigation was in progress between Citibank and Iran in Germany, France, and England. Other U.S. banks were not involved in litigation in all three countries. Because the French litigation was the more pressing at the time, it was a mystery to the Citibank officials why the German intermediaries had made the initial contact rather than the French.

In fact, Citibank was not the only bank approached through Iranian intermediaries. Officials from Bank of America and Morgan Guaranty Trust have recounted tentative feelers at roughly the same time and of a similar nature to the Citibank encounter. Apparently Iran did not specifically select Citibank, but rather simply allowed matters to develop with any one of several of the major U.S. banks with Iranian deposit and loan exposure.

Following the May 2 contact, Hoffman reported to the Treasury Department on May 6 that Citibank had been approached by intermediaries for Iran with what appeared to be legitimate grounds for discussion. Hoffman asked whether the U.S. Government had any objection to his proceeding with these discussions. Deputy Secretary Robert Carswell, a former partner of Hoffman's at Shearman and Sterling, and the principal Treasury Department official responsible

for monitoring the freeze and other financial matters, was receptive to Mr. Hoffman's further pursuit of the Iranian overtures.

Some critics of the informal bank negotiations have questioned the camaraderie between Hoffman and Carswell because the two men represented potentially opposing interests in the Iranian situation. Others have inquired if Carswell let Hoffman proceed to deal with the Iranians (and, they allege, therefore gave Citibank the upper hand in the settlement) because Hoffman was his former colleague. Critics also have inquired whether this relationship prompted Carswell to cut off avenues of discussion for other banks that received similar Iranian overtures. It seems clear that Carswell's prior knowledge of Mr. Hoffman's legal abilities, judgment, and character influenced Carswell's attitude toward the Citibank contact with the German intermediaries. What official would not prefer to deal with someone who possessed that official's confidence and who had shown a willingness to report back to the U.S. government on his contacts with Iran in an accurate and timely manner? In negotiations as sensitive and as turbulent as those in which Hoffman soon found himself, all these confidence factors made a difference.

It was not, however, Mr. Carswell's judgment alone that allowed Hoffman to proceed. Treasury Secretary Miller also approved the contact with Iran's intermediaries, and Miller in turn raised the Hoffman issue at a meeting of the interagency Special Coordinating Committee to secure that group's approval as well. The State Department also was notified about the contact made with Hoffman. Hence, Carswell's opinion of Hoffman was important, but it alone was not enough for Hoffman to continue talking to the Iranian intermediaries. Furthermore, Hoffman was not alone in forming a relationship with Iran. While Hoffman requested and received government permission on May 13 to go ahead, other banks also maintained their informal contacts with Iran, even though those contacts as it turned out proved much less fruitful than Hoffman's. In addition, some non-bank claimants had settlement discussions with Iranian representatives, subject only to a request from Treasury that the U.S. Government be kept informed of developments. The adherence to this request was mixed.

At the early stages of the informal negotiations, both the U.S. Government and Hoffman kept information about the existence of the contacts with Iranian intermediaries extraordinarily secure. Only a few high Administration officials and a small number of Citibank's top executives and lawyers were initially aware of Hoffman's efforts. The Iranian intermediaries had requested that the discussions be kept confidential, and Hoffman was careful not to violate this understanding. Gradually others came to know. Hoffman enlisted help in drafting various documents (selecting Frank Logan of Milbank, Tweed, Hadley and McCloy), and officials for banks such as Morgan Guaranty who had discussed settlement options with Hoffman in the early Plan A era showed continued interest in resolving the Iran situation.

The March 13 U.S. Government approval of further Hoffman-Iranian contacts included certain caveats: Hoffman could only work on a deal which included the release of the hostages; the West German intermediaries were to be told that Hoffman did not repre-

sent the U.S. Government (under the Logan Act, he could not represent the U.S. Government); and that he intended to keep the U.S. Government informed of his discussions with the intermediaries. Finally, Hoffman, as Citibank's representative, informed the West Germans that he spoke exclusively for Citibank and not the other affected U.S. banks. In his own mind, Hoffman had no trouble defending the fact that he kept the Iranian bank negotiations secret from the banking community so long as the discussions centered on a universally acceptable full payout to all banks. A full payout provided no conflict between his client, Citibank, and the interests of other U.S. banks. To the extent he obtained a full payout *every* affected bank would benefit.

After Hoffman and Bank Markazi's West German attorneys agreed on procedural rules, they finally began to discuss substance. A new plan, Plan C, which evolved from the earlier Plans A and B, was the first proposal presented in detail to the West German representatives by Hoffman. In its earliest forms drafted in May 1980, Plan C included the following provisions:

1. A Letter of Credit in favor of Iran would be issued by a bank in a neutral country and funded by the Federal Reserve Bank of New York following negotiations on a compromise of the amounts claimed by Iranian government entities against assets frozen in the U.S. and abroad. Before payment of the Letter of Credit, the International Red Cross would certify that it had custody of the hostages in a neutral location. Iran would assign all its claims to frozen assets to the U.S. government. The U.S. government, as Iran's assignee, would then terminate all foreign litigation against Iran's deposits subsequent to the bank set-offs of their syndicated and non-syndicated loans. Any deposits exceeding those necessary for the set-off would be returned to the U.S. government.

2. U.S. non-bank claims against Iran would be resolved at the claimant's option through newly enacted claims settlement legislation and paid from deposits assigned by Iran to the U.S. Claimants could elect to continue to pursue litigation in domestic and foreign courts, instead of using the new claims process.

3. Funds remaining after claims settlement and after reimbursement for U.S. funding of the Letter of Credit would be returned to Iran.

Later drafts of Plan C took a slightly different approach.

1. All U.S. banks with overseas deposits would agree to permit Bank Markazi to buy out their liquidated U.S. dollar debt claims using overseas deposits of the respective U.S. bank, and the remaining overseas deposits would be retained by means of a Letter of Credit for Iran issued by a neutral bank. The Letter of Credit would be payable when the Red Cross certified its custody of the hostages, when Treasury licensed the transaction, and when two other agreements relating to payment of loan and contract claims were in place.

2. At the claimant's option, contract claims would be adjudicated by a court of law or by the Foreign Claims Settlement Commission, and in the case of a Commission judgment, claims would be paid from Iranian assets held at the Federal Reserve Bank of New York.

As Plan C evolved between May and October 1980, there was a firm adherence to the principle that the payment of liquidated debts should come out of overseas bank deposits. Liquidated debt was an attractive target because it was easily quantifiable and because, in the case of liquidated bank debt, it would simultaneously release foreign banks from their portions of the syndicated loans, thereby preventing any foreign bank challenges that U.S. banks were getting preferential treatment.

The overseas U.S. bank deposits were the easiest to deal with because of the relatively few institutions involved, because the amount of the deposits were very large (far greater than the outstanding dollar loans), and because those deposits were much less encumbered with attachments than the domestic deposits. As Plan C evolved, the question of how to resolve the payment of non-liquidated claims was one that underwent the most revision. The spectrum of proposals in the various drafts ranged from a general commitment by the parties to negotiate a claims settlement program after release of the hostages, to an agreement to establish a claims settlement program simultaneous with the payment of other debts and the release of the hostages. Gradually, funding for the claims settlement program came to be linked with Iranian assets held in domestic branches of U.S. banks.

After each session with the German intermediaries, Hoffman would report back to the U.S. Government in person (a precaution suggested by Carswell as an alternative to telephone contacts). Carswell and other U.S. Government officials such as Robert Mundheim, Treasury's General Counsel, and Roberts Owen, State's Legal Adviser, were generally present during these meetings. Hoffman would also provide copies of any major revisions of Plan C to the U.S. Government. While the U.S. Government officials would not suggest revisions to the Hoffman plans or attempt to dictate how the negotiations should go, Carswell would pass the Hoffman drafts on to his lawyers for their review.

As time went on, and as the U.S. Government became more active in its diplomatic negotiations, Hoffman became concerned that his efforts might conflict with the U.S. Government's negotiations. It has been determined that the U.S. Government never reported its positions to Hoffman in spite of his willingness to keep the U.S. Government negotiators fully apprised of his efforts. For example, Hoffman first learned of the specifics of the U.S. Government's settlement proposals when they were leaked by the Iranians and published in the *New York Times* on December 29, 1980. Many other details of the agreement first came to Hoffman's attention after the release of the hostages.

Carswell for his part was careful in checking Hoffman's drafts to make sure they were within the bounds of the U.S. negotiating position. Carswell was concerned that Iran's intermediaries might wrongly perceive a Hoffman offer as a U.S. Government trial balloon if the offer was different from the official U.S. negotiating position.

The negotiations on Plan C came to an abrupt halt in mid-November 1980 when the Iranians disapproved the Plan C concept. Mr. Hoffman immediately began to develop Plan D, in concert with representatives of other U.S. banks. The other banks were now necessary parties because Iran had rejected the idea of paying off all bank loans (an idea to which no bank could realistically have objected) in favor of an approach calling for all loan payments in arrears to be paid and out-

standing loans to remain in force. This new approach was one on which different banks could have different views. Therefore a broader representation from U.S. banks was necessary.

Plan D included some of the same provisions as Plan C, the principal difference being that only matured, liquidated debt claims would be paid off, while unmatured debt claims would be brought current. Future payments of the unmatured claims would be secured by a guarantee through external debt service arrangements. In addition to guarantees by the Iranian government and the Bank Markazi, one very early draft of Plan D involved a sinking fund to be established in a neutral bank in order to fund 18 months of debt service on the unmatured loans. The November and December drafts of Plan D contained various guarantee provisions, such as a 24-month sinking fund arrangement; a collateralization of a certain percentage of the outstanding debt; a full guarantee by one or more European banks in lieu of a particular collateral amount; and a requirement for collateralization through Iranian deposits in overseas branches of U.S. banks (in the event the debts were not guaranteed by a European bank). Some versions of Plan D included the National Iranian Oil Company as an additional Iranian guarantor of future debt payments, and other drafts contained deadlines for implementation of the financial settlement by Iran and Bank Markazi.

In December, some of the U.S. bankers became worried that the come-current approach, then actively being discussed with the Iranian intermediaries, might not include any form of collateralization of future payments. The first indication of such a possibility came when Deputy Secretary Robert Carswell, early in December 1980, individually visited the U.S. banks. In those visits he apparently alluded to the fact that the banks should be prepared to make fast decisions on settlement terms, and that all of the terms might not completely satisfy all of the banks. While Deputy Secretary Carswell was not specific in his discussion of possible terms of agreement, many of the bankers inferred they might receive no more than a payoff of past-due installments and a vague promise for future payment. The secret U.S. Government terms published in the *New York Times* on December 29 supported this view. These leaked documents, dated December 3, made it clear that the U.S. was bargaining with the Iranians on terms that did not include set collateralization of the future debt service. Specifically the U.S. Government proposal required that each loan would be "brought current and affirmed by the Government of Iran", and the parties would "consult concerning the normalization of their banking relationships." This requirement was far from the kind of detailed protections for future payments that the U.S. bankers were hoping Iran would accept.

The bankers had more reason for optimism from what was happening in John Hoffman's negotiations. Hoffman was reporting back to his U.S. banking colleagues that the Iranian intermediaries were raising no objections to the security provisions in the drafts of Plan D that he was discussing with them. Therefore, in reliance on Hoffman's judgment of Iranian willingness to accept specific security provisions, the other U.S. bankers continued to believe that an agreement with some form of collateralization could be negotiated.

By early January 1981, as the formal government negotiations and the informal bank negotiations merged, the banks' drafts of Plan D continued to include security provisions. In addition, the U.S. banks drafts, for the first time, began to reflect the roles of the Algerians and escrow arrangements involving an unspecified foreign central bank. Some drafts of Plan D from January 1981 included options for payment of the matured debt claims either by direct set-offs against Iranian deposits in U.S. banks or by indirect payment from an escrow account funded by these deposits. While the U.S. bankers were hopeful of avoiding a circular payment through an escrow account, those closest to the Iranian representatives expected Iran to insist on an escrow arrangement. That arrangement would create the appearance of a larger dollar payoff to Iran, even though the net result in U.S. dollars to Iran would be the same under either a direct or indirect payment.

The final draft of Plan D was drawn up just days before the January 15 Iranian decision to abandon the come-current concept of Plan D and to revert to the concept of full payment of the bank debt. This change to the full payment approach to a great extent reflected the previously rejected Plan C.

A chronology and examination of Plans C and D, from May 1980 to January 1981, does not accurately convey how difficult and frustrating the informal bank negotiations were. Undoubtedly all other informal, non-U.S. Government contacts involving other U.S. banks or corporations reflected similar frustrations. The Iranians' preference to work through intermediaries rather than principals meant that the U.S. bankers were never sure which of the Iranian factions was on the other side of the bargaining table. As the formal U.S. government negotiations developed, Minister of State Behzad Nabavi and the clerical faction were on the receiving end of the official U.S. diplomatic offers. The U.S. bankers were dealing with emissaries for Bank Markazi, which was headed by Ali Riza Nobari, a loyalist to the faction of President Abol Hassan Bani-Sadr. In addition, the U.S. bankers were dealing with Bank Markazi's London solicitor, Roger Brown of the law firm of Stephenson Harwood, in connection with the litigation going on in Great Britain. By December and January, all three avenues to Iran that had been nurtured (the West German bankers' track, the Roger Brown track and the formal diplomatic Algerian track) were being used to send messages to all factions in Iran. The intense rivalry between Bani-Sadr's more Western-oriented faction, itself a fractionalized group of diverse interests, and the fundamentalist, clergy-controlled Islamic Republican Party, has dominated Iranian politics since the revolution and was reflected clearly in the lengthy hostage negotiation process.

During the six weeks prior to the signing of the agreement, the U.S. bankers' efforts to arrange the logistics of executing a settlement became nearly as important as the specifics of the settlement itself. The U.S. bank lawyers, beginning in mid-December, were at work on the mundane tasks of working out procedural details of the agreement. This required developing reliable statistics on the deposits and loans held by each U.S. bank. The U.S. banks did not collaborate directly on this "number-crunching" effort—rather, they hired Peat, Marwick, Mitchell and Co. to gather the loan figures and brought together the deposit and interest data which could reliably be conveyed to the Iranians.

The U.S. banks also had to determine the amounts of interest due on the Iranian deposits. In originally contracting with Iran to pay interest on certain of its accounts, each U.S. bank had agreed to pay interest on those deposits at specified rates. When the settlement accounting began in January 1981, some banks were willing to commit to pay the prevailing market rate of interest while others believed that a lower, historically based rate was more appropriate. Starting from the figure each bank thought was reasonable for its own deposits, the major U.S. banks determined that they owed Iranian depositors an aggregate total of $670 million in interest. When Iran dramatically changed course on January 15 and agreed to pay off its U.S. bank loans, it also demanded $800 million in interest, $130 million more than the U.S. banks had offered. To arrive at the $800 million figure Iran had rejected the historical rate concept and instead simply extracted the highest rate offered by any U.S. bank and applied that rate across the board to the total principal amount of Iranian deposits.

On January 16, 1981, by invitation from the U.S. Government, Chief Executive Officers and lawyers for the U.S. banks and U.S. Government officials met at the State Department to solve this interest payment dilemma. Those U.S. banks that had offered Iran a rate of interest less than the prevailing market rate naturally were very reluctant to embrace a plan to pay the disputed amounts of interest into a special conditional interest fund which would be distributed upon determination of the legitimacy of Iran's interest payment claims. Eventually, late in the day on January 16, the representatives of Bankers Trust and Bank of America (whose institutions held deposits accounting for over 84 percent of the $130 million in disputed interest) reluctantly agreed to the conditional fund concept.

One other issue resolved in that important January 16 meeting at the State Department was the issue of which loans, syndicated or non-syndicated or a combination of both, would be paid off with the funds that Iran had agreed to return to the U.S. Several U.S. Government officials gave serious consideration to whether an across-the-board, proportionate repayment of each type of loan would be feasible. The problem they foresaw with what might seem to be the more equitable across the board approach was that it would leave a large number of loans in a state of partial repayment and would be extremely cumbersome to implement in what they knew would be a very limited period of time. Instead of the across the board approach, the U.S. banks agreed to a full payout of the syndicated loans, thereby wiping those loans off the participating banks' books. They agreed to provide for the escrow of other funds to pay off non-syndicated loans after any dispute about those loans had been resolved through settlement or arbitration.

The U.S. bankers' agreement removed both the foreign banks, and many regionally based U.S. banks who were participants in the syndicated loans, from long-term Iranian exposure. The agreement left the major U.S. banks, who had both syndicated and the majority of direct loans with Iran, subject to sizable amounts of delayed repayment pending the results of settlement or arbitration. The theory behind this order of loan repayment was that if a bank believed it

had the sophistication and clout to make direct loans to Iran, then that bank could most likely bear the burden of delay. The theory also held that the banks involved in direct lending could bear the loss if the settlement and arbitration process ruled against them or the process itself eventually failed.

Nothing has been found to substantiate allegations criticizing the role played by the U.S. banks in the hostage settlement, We believe the U.S. banks did not control the negotiating process or the terms of the agreement. The U.S. Government (not the banks) froze Iranian assets and preserved the status quo of November 14, 1979. Any settlement, regardless of how favorable to any U.S. party, had to have the assent of the U.S. Government before the freeze could be lifted. The Iranians, not the U.S. Government or U.S. banks, set the terms of the financial agreement by their January 15 decision to provide for repayment of U.S. loans rather than the "come-current" approach.

Similarly, there is no truth to the allegation that the U.S. banks managed to feather their own nests by arranging for a full pay-off, while leaving U.S. non-bank claimants without an effective mechanism to resolve their financial disputes with Iran. If the final agreements discriminate against U.S. non-bank claimants it is not the U.S. banks but the U.S. Government that is responsible for such a decision. In May 1980, Treasury Secretary Miller through Deputy Secretary Robert Carswell articulated to John Hoffman the fundamental U.S. policy that *all* U.S. claimants had to be protected in any settlement. Aside from the direct needs of his client, Citibank, which had some nonliquidated claims against Iran, John Hoffman had no particular responsibility to negotiate the terms of a claims settlement agreement. Carswell neither encouraged nor discouraged Hoffman from including such provisions in his drafts, but simply made sure that Hoffman did not propose anything relating to claims settlement that was outside the broad scope of the U.S. negotiating position. As the U.S. began to establish better diplomatic negotiating contacts with Iran (around the time Plan D was being developed in November), Hoffman's efforts concentrated more on the bank issues and less on the claims settlement problem.

There was, to be sure, no counterpart to Hoffman for the non-bank claimants. The contractors had such a wide variety of interests that no one contractor or group of contractors could be assured of speaking with authority to Iran's intermediaries. The U.S. Government's response to this was to develop the claims settlement approach on its own using the Government's diplomatic channel, beginning in the Fall of 1980.

Procedurally, one might question how the claims settlement was handled by the Government. The bankers had as much as six months to work over ideas and theories of a bank settlement with Iran's intermediaries before the details of a non-bank claims settlement was formally presented to Iran by the Government. It is difficult to assess whether those early bank contacts were crucial in the ultimate settlement, and whether similar protracted negotiation of a claims settlement agreement would have yielded a greatly improved product for contractor claims. Nevertheless, the impression with which one is left

in examining the broad negotiating scheme is that Government efforts to work out a comprehensive settlement for contractors were not undertaken with the same sense of concern as existed for U.S. bankers.

At least in part this difference in treatment may have resulted from bureaucratic structure. Treasury played a lead role in organizing meetings with bank and non-bank claimants early in 1980, but by year and the State Department had taken over primary responsibility for working out a claims settlement for contractors. Past international claims settlements were traditionally the role of the Department of State. It is hard to judge, in the context of the extraordinary nature of the Iranian situation, whether the traditional roles, attitudes and interests of the two departments enhanced or diminished the fairness of the overall settlement.

There are a host of reasons to explain why banks and non-banks emerged with different results from the hostage settlement. Those reasons are amply discussed elsewhere in this report. Strong arguments can be made that, for all the potential pitfalls in the Claims Tribunal, non-bank claimants are better off now than before the freeze. It is appropriate to suggest, however, that the concerns expressed about the fairness of the respective settlements are not entirely without merit. In that light, the Executive departments should do what they can to ensure that bureaucratic rivalries and other extraneous factors do not affect the negotiating process if it becomes necessary to use IEEPA in the future. Among ways to do that might be to clearly vest authority for settlements relating to all parties in one department rather than two or more.

Another allegation directed at the bank negotiators is that Citibank's contacts with the Iranian intermediaries permitted Citibank officials to negotiate a preferential deal for themselves to the detriment of the other U.S. banks. In fact, Citibank negotiators carefully avoided placing themselves in a position to make such an inside deal. John Hoffman's secret negotiations with the West German intermediaries remained secret from his U.S. bank colleagues only as long as his proposals (Plans A, B, and C), called for full payment of all liquidated U.S. bank debt. When the Iranians switched to a "come-current" approach in mid-November 1980, Hoffman immediately brought other U.S. bankers into the negotiation strategy sessions.

As a practical matter, there are a number of reasons to explain why the final hostage settlement affected U.S. banks in differing ways. None of these reasons suggests a conspiracy by Citibank. The November 14, 1979 freeze caught U.S. banks in widely divergent deposit and loan postures with respect to Iran. Bank of America, for example, had over four times more Iranian dollar deposits in overseas branches than any other U.S. bank, and in relation to its huge amount of deposits, it had a small amount of loan exposure. Chemical Bank, on the other hand, had seven times as many dollars tied up in loans to Iran as it had Iranian overseas deposits. Given this spectrum of interests, any financial settlement agreement would be bound to have differing impacts on the U.S. banks.

There is no evidence that the competitive interest of a single U.S. bank dictated the form of the final agreements. It simply must not be forgotten that the principal ingredients of the financial aspects

of the final settlement agreement came from Iran and not from Citibank, nor from any other U.S. bank, nor from the U.S. Government negotiators. By mid-January the U.S. banks had long since abandoned hope of a "full payoff" and had been working for nearly two months on a "come-current" approach. The Iranians surprisingly changed course on January 15 with the decision to pay off the bank debt, to the apparent delight of both the U.S. Government and the U.S. bank negotiators. It was Iran, not the U.S. Government, Citibank or any other U.S. bank, that insisted on the $800 million in interest for its deposits. This $800 million figure affected some banks, particularly Bank of America, more than others and resulted in substantial disputed interest payments into the escrow account. Finally, it was the collective judgment of the U.S. banks, on January 16, in consultation with U.S. Government representatives, that led to the immediate payoff of syndicated loans and deferred payment of the non-syndicated loans from the escrow account. This arrangement, while affecting some banks more adversely than others, was not the result of the special negotiating position of Citibank, but the decision of the U.S. banks participating at the January 16 meeting.

There is absolutely no reason to believe that Citibank's secret negotiations with Iranian intermediaries led to an agreement that favored Citibank's position over other U.S. banks. Similarly, there is nothing to support the view that Deputy Secretary Robert Carswell's previous association with John Hoffman, as private attorneys, in any way affected the outcome of the settlement to Citibank's favor. The prior association of Deputy Secretary Carswell with Mr. Hoffman helped foster some useful and dependable lines of communication between U.S. parties and Iranian parties during a period of time when any serious contacts with Iran were certainly in the best interests of the United States. Mr. Hoffman and his banking colleagues, who took part in the U.S. bank negotiations with Iranian intermediaries, provided a valuable non-Governmental forum for the exchange of views on very complicated financial matters. The Iranian negotiators independently chose many of the ideas first developed by Mr. Hoffman as part of their final settlement proposals.

In sum, Mr. Hoffman and his banking colleagues deserve commendation for having undertaken a difficult and frustrating role, rather than criticism for their efforts.

V. THE ROLE OF THE FEDERAL RESERVE: TEAM PLAYER OR OBSTRUCTIONIST?

The Federal Reserve Bank of New York played one of the most significant and yet least visible roles in the Iranian hostage settlement. (The Bank will be referred to as the New York Fed in this section). Under the final agreement, the New York Fed was responsible for collecting Iranian assets, transferring them to the Bank of England for credit to accounts in the name of the Algerian Central Bank, and receiving in return the dollars committed to liquidation of the syndicated bank debt. U.S. banks entrusted the New York Fed with billions of dollars in cash, gold and securities for timely transmission during the critical final hours as a condition precedent to the release of the hostages. The cash, gold and securities came from the New York Fed's vaults and from foreign branches of U.S. banks. Given the complicated nature of the financial transactions, and the financial and political sensitivities of the other participating central banks, the hostage release simply could not have been as successful, and may not have occurred at all, without the cooperation and participation of the New York Fed.

Despite this cooperation, newspaper accounts have alleged that the New York Fed came precariously close to delaying, if not preventing, the final release of the hostages. According to these accounts, the Bank's officials were too concerned about preserving the Federal Reserve's jealously-guarded independence from U.S. Government control. The newspaper accounts allege that Ernest Patrikis, Deputy General Counsel of the New York Fed and the Fed's representative with the U.S. negotiating team in Algiers, jeopardized the hostage settlement by refusing at the last moment to sign certain agreements made between the U.S. Government, the Algerian intermediaries, and Iran. Such allegations of legal nitpicking and bureaucratic delay are all the more fascinating because of a newspaper report that a frantic President Carter talked directly to Patrikis in Algiers and, with barely controlled anger, urged him to contact more senior Fed officials and get his problems resolved. The Washington Post, on January 25, 1981, reported the incident as follows:

> One last crisis, a few hours before the inaugural ceremony, was created, strangely enough, by an American lawyer in Algiers, representing the Federal Reserve Bank of New York, refusing to sign a final "annex" that would send the money on its complicated international journey. Carter, in a final frustration of power, was informed that he could not command the lawyer to sign the paper because the lawyer worked for the "independent" Federal Reserve, not for the president.

Later in the same article, the Post gave more details of the alleged incident:

> Suddenly the problem isn't with the Iranians. It is with the Federal Reserve lawyer, Ernest Petrinkis [sic], who is with Warren Christopher in Al-

geria. Petrinkis won't sign the amended codicil, citing technicalities the president doesn't even want to hear about.

The president is furious. He calls Tony Solomon, head of the Federal Reserve Bank in New York and wakes him up. He asks Cutler, his lawyer, what powers the president has to order the Federal Reserve, an autonomous body, to sign the document.

Between 4:05 and 4:30 a.m., there are three conference calls to the lawyer in Algiers. At one point the president, in revealingly measured tones, tells the lawyer to call his boss. Carter, president of the United States, powerful world leader, is slowly reading Solomon's home phone number, digit by digit, to a middle-level government lawyer.

The lawyer apparently doesn't make the call. At 5:07, a Treasury Department lawyer, Rich Davis, gets on a conference call with Solomon and Petrinkis in Algiers, explaining why the document should be signed. It's signed.

This section of the report analyzes in detail the general issue of the Federal Reserve's involvement in the hostage crisis, and in particular, the specific allegations about Mr. Patrikis.

The role of the Federal Reserve in the Iranian crisis began well before the hostages were taken in November of 1979. Throughout the period of instability in Iran, the Federal Reserve contributed valuable information to the U.S. decisionmakers who were concerned with the potential impact of the Iranian crisis on the U.S. economy and its impact on U.S. commercial banks. As a matter of course, the Federal Reserve, in cooperation with the U.S. Treasury Department, collects and reports critical information on foreign deposits in U.S. banks and loan exposure of U.S. banks to foreign countries. The Fed compiles the claims information by country; and divides the information within each country into subcategories labelled "banks", "public borrowers" and "all other borrowers"; and into four categories of maturities ranging from one year and under to over five years. The reports include no data on individual borrowers or depositors.

U.S. banks routinely report some of this critical information to the Fed on a monthly basis. They report quarterly other, more detailed, information on exposure to particular countries. Because of the infrequency of these reports much of this information can easily become outdated.

With Iran in 1979 there was a particular problem of accuracy of information, as the level of Iranian deposits in U.S. banks during 1979 was particularly volatile. This volatility was due to the fact that some major U.S. banks served as pass-through agents for payments to the National Iranian Oil Company (NIOC). Initially, Chase Manhattan Bank, and later other U.S. banks, served as NIOC agents for deposit flows as high as $40 to $50 million per day. During late 1979, Iran had terminated its longstanding NIOC account with Chase (apparently because of Chase's association with the Shah and as a result of vigorous solicitation by Bank of America and possibly others for the account) and transferred that NIOC account to the Bank of America. Thus, at the time of the freeze, Chase had a relatively small amount of Iranian deposits while Bank of America had a relatively large amount.

After the hostages were taken on November 4, 1979, U.S. policymakers had to know more accurately the aggregate Iranian deposit and loan exposure for U.S. banks in order to judge the impact of potential sanctions against Iran. Since the latest information gathered by the Federal Reserve was no more recent than September 30th, 1979 (and

some was even older), and due to the volatility of Iran's deposit levels with U.S. banks, the Federal Reserve assisted in helping to gather last-minute, up-to-date information about the balance sheet of Iran with U.S. banks. On November 10, 1979, in response to a request for emergency assistance from Treasury Secretary Miller, Federal Reserve Board Chairman Paul Volcker directed New York Fed Senior Vice President Scott Pardee to gather up-to-date information from U.S. bankers on Iranian deposits and loans.

Pardee called each of the major New York banks that held accounts with Iran to determine the latest status of their Iranian deposits and loans. Pardee's contacts were at all levels of the New York banks, ranging from chief executive officers to international banking specialists. By Monday, November 12th, which was a legal holiday, Pardee had gathered enough information to pass some statistics along in a conference call to Treasury Department employees who had been engaged in a similar exercise of updating the U.S.-Iran balance sheet.

While Pardee's contacts were meant to be informational and statistical, he was also instructed to take note of any comments that bankers might make about the possibility of an assets freeze. The bankers who did comment on the possibility of a freeze were generally negative. Quite obviously, many of the veteran New York bankers had experienced other asset freezes and therefore correctly sensed the possibility of another freeze.

There was a difference of viewpoint among bankers on whether a freeze was desirable. The difference depended in large part on the portfolio positions of the commenting banks. For example, those institutions with large Iranian deposits and few loans to Iran were not concerned about a potential Iranian threat to withdraw its money. Those institutions with large loan exposures and few deposits would be more troubled by a threat to repudiate loans.

The reason for these differing positions was that Iran's fleeing deposits would generally return to the U.S. banking system after being funnelled through a foreign bank or the Eurodollar market or both. This "recycling" concept, which was widely accepted by those familiar with the Eurodollar market, meant that a bank could generally get back what it lost in withdrawn deposits if it was willing to pay a premium in the Eurodollar market. On the other hand, a repudiated loan, and particularly one without any possibility of setoff against an Iranian deposit, could not be recouped in a similar fashion. Accordingly, those institutions with large loan portfolios and few deposits were more interested in the potential value of a freeze, and in preserving the status quo, than those relatively secure institutions with deposits far in excess of their Iranian loans.

The opinion of the Federal Reserve itself seems to have been decidedly against a freeze. The Fed opposition was clearly guided by its desire to maintain its view that deposits in the U.S. central bank enjoyed the sanctity and protection of a stable U.S. financial system separate and distinct from domestic political conditions. Any action approaching a freeze, creating the appearance of nervousness or instability in the American financial marketplace, made it exceedingly difficult for U.S. central bankers to deal confidently with their foreign counterparts. In addition, foreign banks could attempt to use the appearance of instability in the U.S. financial system for their own competitive advantage.

Aside from his weekend telephone survey, Mr. Pardee was involved in another series of phone calls initiated in the early morning of November 14, just prior to the imposition of the freeze. The calls responded to Bani-Sadr's statement early on the 14th threatening Iranian loan repudiation and deposit withdrawals. In effect, Pardee delivered the message that the banks should know that the U.S. Government was on top of the situation and that it was prepared to act very quickly. The banks were encouraged not to unilaterally do anything that could complicate the governmental actions. Pardee completed only a few of these calls prior to the wire service announcement of the freeze. Later in the day on the 14th, Pardee and James Oltman. General Counsel of the New York Fed, met with various bankers to explain the freeze in detail and to determine the extent of Iranian deposits remaining in the financial system's pipeline. Many bankers expressed concern about the implications of the freeze. The New York Fed officials were given the difficult task of assuring the bankers that the freeze was in the nation's best interest and that the banks should be prepared to adjust to, and understand, the complex reasons why a freeze was necessary.

New York Fed officials, and particularly Ernest Patrikis, assisted Treasury officials in drafting the regulations to implement the freeze. The technical expertise of the New York Fed staff was a valuable adjunct to the regulatory effort. The New York Fed also served as a conduit for advising banks under its jurisdiction of decisions rendered by Treasury under its licensing regulations.

As a final hostage agreement began to take shape in late 1980, it became clear that the central banks of several countries would be absolutely necessary as escrow agents and as depositories for the funds that were to be transferred. The New York Fed agreed to provide any central bank services for the United States and to act as the fiscal agent for the United States as it had on numerous occasions in the past. As the fiscal agent, the New York Fed could perform a wide variety of financial functions on behalf of the United States, on instructions from the Department of the Treasury, without responsibility or liability for the substantive portions of the underlying transaction.

The relationship between the Treasury Department and the New York Fed was embodied in a Fiscal Agency Agreement formally signed on January 18, 1981 by Treasury Secretary G. William Miller and New York Fed General Counsel James Oltman. The agreement designated the New York Fed as the Fiscal Agent for the United States, with the authority to enter into an agreement with the Bank of England and the Central Bank of Algeria for the transfers of money called for in the hostage settlement agreement. The Fiscal Agency Agreement also allowed the New York Fed to provide any necessary indemnities, and the Treasury Department agreed to reimburse the New York Fed, subject to congressional authorization and appropriation of funds, for any costs incurred by the New York Fed arising out of the Fiscal Agency Agreement. In the event that the Treasury Department failed to reimburse these costs, the Fiscal Agency Agreement permitted the New York Fed to reimburse itself for those potential losses out of its own earnings. The Secretary of the Treasury acknowledged that if the New York Fed were required to

reimburse itself, the net earnings of the Fed that would normally be available for distribution to the U.S. Treasury would most likely be reduced.

The issue of indemnity was a critical one under the Fiscal Agency Agreement. The Bank of England, acting as depository for the Algerian escrow accounts, was deeply concerned about its own potential exposure in the event the hostage deal was not consummated according to plan. The Bank of England refused to accept indemnification from the U.S. Treasury Department because Treasury only offered a conditional indemnification subject to funds being authorized and appropriated by Congress. Thus, the New York Fed became responsible for directly indemnifying the Bank of England. The New York Fed was in turn indemnified by Treasury under the Fiscal Agency Agreement, although it was subject to Congressional authorization and appropriation of funds to the Treasury Department. This arrangement was exactly the same as the previously refused indemnification offered by Treasury to the Bank of England. To require such a complicated multi-tiered indemnity is not unique for bankers who, to say the least, are extremely prudent in matters of potential liability. The indemnity arrangement did not in any way delay the settlement of the hostage crisis because the need for such an arrangement was understood well before the final negotiations took place.

The New York Fed took special precautions to make sure that the Board of Governors of the Federal Reserve specifically approved the Fiscal Agency Agreement with the Treasury Department. That approval came on January 13, 1981. In its presentation to the Board of Governors, the New York Fed noted that it would be directed by the President to indemnify the Bank of England under an Executive Order issued under the International Emergency Economic Powers Act. This arrangement shows that the Federal Reserve Board was prepared to act in accordance with the President's wishes. This cooperation differs significantly from implications in newspaper accounts that the Fed resisted carrying out the desires of Executive Branch officials.

The New York Fed's presentation to the Board also noted that in the event the Treasury failed to reimburse the Fed for indemnification expenses, the New York Fed would, for accounting purposes, book its claim against the Treasury Department as an asset, and reduce the usual annual payments from net earnings to the Treasury Department. This complicated procedure was extremely important because it would prevent the New York Fed's technical insolvency if the losses occurring under the Fiscal Agency Agreement exceeded the New York Fed's capital.

During the final critical days before the settlement agreement was signed, New York Fed General Counsel James Oltman was physically located at the Treasury Department and Deputy General Counsel Ernest Patrikis was in Algiers with the U.S. negotiating team. Patrikis, working with former Treasury General Counsel Robert Mundheim and Bill Lake from the Department of State Legal Adviser's Office, drafted the escrow agreement, and related documents which resolved the financial aspects of the hostage settlement.

The inter-relationship of the documents that were drafted during those final days is necessary to understand the complicated discussions and decisions of the last hectic hours before the settlement was reached.

Originally, American negotiators envisioned that the number of documents needed to settle the hostage situation would be rather small. They intended to have two Declarations, one describing in general the financial transactions and a second establishing the non-bank claims settlement mechanism. In addition, there was to be a detailed escrow agreement to instruct the technical parties on the transfer of funds between the U.S., England, and Iran.

It is important to note that the well-laid drafting plans fell apart on January 15th when the Iranians surprisingly agreed simply to pay off U.S. bank loans rather than continue with the very complex proposal to "come current" on the bank loans. This major substantive change in position, along with a further Iranian procedural demand to remove references to specific dollar amounts from the Declaration to be transmitted under the agreement, required the U.S. negotiators to reorganize and redraft the various documents then being prepared. Because the Declarations were to be public documents, the Iranians wanted all specific dollar amounts to be put in a separate document called the Undertakings. The parties agreed that these Undertakings would not be released to the public until some time after the hostages were released. Some participants speculate that the Iranians insisted on this arrangment because they did not want it publicly known that the hostage settlement agreement, specifically the net amount of dollars available to Iran after the transfer took place ($2.87 billion), was as poor a financial bargain as it appeared to be.

Undoubtedly, this acute sensitivity to public examination of actual dollar amounts, if true, is explained by the intense factional infighting in Iran which consistently went on throughout the course of the hostage negotiations. The Iranian faction negotiating the agreement apparently feared they might be publicly embarrassed if the actual figures leaked out. The net dollar amounts that would go to Iran under the agreement were much smaller than originally demanded. In late December 1980, Iranian demands had been for $24 billion from the U.S. As the serious negotiations evolved, the $24 billion demand had been gradually scaled down to approximately $8 billion, an amount which still dwarfed the eventual net figure of less than $3 billion Iran received after the hostages were released.

While the State Department team (consisting of Warren Christopher, Roberts Owen, and Harold Saunders) was redrafting the revised Undertakings on the second floor of the U.S. Embassy in Algiers, the financial team located on the first floor had problems of their own. The financial team had the difficult task of arbitrating an impasse between the two other participating central banks, the Bank of England and the Banque Centrale d'Algerie. The Bank of England preferred the traditional, very detailed escrow agreement that provided minimum flexibility and discretion and no exposure or liability to the participating central banks.

On the other hand, the Algerians preferred a non-traditional, brief and general escrow agreement. Participants in the process thought that the Algerian central bankers preferred this atypical escrow agreement so that their role in the final hostage settlement would not be

remembered as clerical but would be perceived as a major policy and political role. These conflicting demands required abandoning the preferable single escrow agreement in favor of a series of documents: (1) an escrow agreement between the Government of the U.S., the New York Fed, the Bank Markazi, and the Algerian Central Bank; (2) a technical arrangement between the three central banks, including the Bank of England; and (3) a detailed document called the Implementing Technical Clarifications and Directions, which was to be signed by the U.S. Government, the New York Fed, the Bank Markazi, and the Algerian Central Bank.

Included in the Implementing Technical Clarifications and Directions was an Attachment B, which contained detailed numbers listing the amounts of principal and interest in Iranian deposits held overseas by each U.S. bank involved. These deposits were scheduled to be transferred through the New York Fed to the escrow accounts in the Bank of England. In effect, this Attachment B was a payment instruction that the U.S. banks required be approved and sent by the Bank Markazi before the Iranian deposits would be turned over to the New York Fed. This payment order is a typical device used when a depositor wants funds transferred by a bank that holds its deposits.

All these technical financial documents were given to the Algerians for transmittal to Iran late on the weekend prior to January 20th. For some reason, which has yet to be adequately explained, all of these documents were not transmitted to Iran at the same time, but rather were sent sequentially. Therefore, the escrow agreement and the technical arrangement arrived in Tehran first. Iranian officials agreed to them and signed them. The Implementing Technical Clarifications and Directions, however, were delayed in arrival, and when the Iranians finally received them, they immediately attacked the document as a questionable last-minute insertion and a substantive attempt to undercut the previous agreements.

All indications are that this Iranian interpretation of these documents or their order of transmission was distorted and unfounded. The Algerians, as intermediaries for Iran, previously had seen these documents and had approved them, and, according to several U.S. participants. Roger Brown, the Bank Markazi representative in London, saw the documents in a timely manner on Sunday morning, January 18, in London. U.S. participants report he raised no serious procedural or substantive objections to them. It is very likely that Roger Brown sent copies of these documents to Iran on Sunday, January 18. It seems unlikely, therefore, that Iran was surprised by the content of the documents which they received later through the separate Algerian channel.

In any event, the Iranians objected not only to the specific numbers contained in the Attachment B, but also to a sentence in Attachment B which appeared to represent a general waiver by Iran of any right to later dispute the deposit principal and interest figures contained in Attachment B. In this respect the Iranians may have had a good point. The hostage settlement agreement generally permitted Iran to contest disputed interest amounts through arbitration and ultimately through the Iran-U.S. Claims Tribunal. The Attachment B language might have raised doubts about whether the U.S. was attempting

underhandedly to preclude that previously agreed-upon course of action. There is no indication that the language, which U.S. bankers submitted to U.S. government negotiators, was anything more than common boilerplate which was never intended to achieve the result feared by Iran.

When the U.S. officials in Washington were advised of Iran's objection to this general waiver language, they consulted with the U.S. bank lawyers and soon mutually agreed to an acceptable substitute which specified that Iran was not waiving any future right to dispute amounts of principal and interest. The draft substitute payment order was transmitted to Roger Brown, who in turn initiated his own revision of the payment instructions addressing the Iranian objections. The Brown payment order redraft ultimately did not include the proposed U.S. substitute language and therefore intentionally avoided the waiver issue. In any case, the Brown revised payment order was the one finally used to authorize the transmission of funds from Iranian bank accounts to the New York Fed.

The complexities associated with Annex B that arose on Monday, January 19, were neither the only problems nor the last problem that complicated the final hostage settlement. The document to which Annex B was attached, the Implementing Technical Clarifications and Directions, became the next focal point of dispute.

Early in the morning of January 20, the Iranians sent word from Tehran that they had decided not to sign the Technical Clarifications. The Iranian refusal to sign the Technical Clarifications, with its detailed escrow instructions and accompanying payment order language in Attachment B, appeared to be a major impediment to final concurrence on a prudently drafted financial agreement. With the clock ticking away toward noon on Inauguration Day, the latest Iranian position seemed to be another exasperating complication to the hostage settlement. Nevertheless, the few individuals who were totally familiar with all of the documents that would form the agreement knew that the Iranian failure to sign the Implementing Technical Clarifications and Directions was not a crucial blow. Roger Brown had drafted a payment order that would replace Attachment B, and the technical details of the Implementing Clarifications were in fact not crucial to the orderly transfer of funds called for under the agreement.

Unfortunately, for a variety of reasons such as the poor working conditions, physical exhaustion, and the pressure of the fast-approaching Inauguration, Ernest Patrikis, the Federal Reserve's representative in Algiers, was not aware of the content of another part of the agreement known as the Undertakings. Patrikis was deeply concerned about adequate financial protection of the U.S. position if the Implementing Technical Clarifications and Directions were not part of the agreement. As the representative of the fiscal agent for the United States, Patrikis had a legitimate reason to make sure that the mechanism for transferring funds was intact. In addition, the New York Fed had held gold, securities, and cash in its own coffers that were part of the transferred assets and that could cause legal complications for the Bank, as a depository, if the agreement fell through.

In light of this, Patrikis decided to review the various documents to assure himself that the U.S. and the New York Fed were adequately protected. He consulted with James Oltman, the General Counsel of

the New York Fed, and with Treasury Department officials in Washington to make sure that all necessary documentation was in order. The crucial factor explaining Patrikis' concern was that he had not seen the document entitled the Undertakings.

The Undertakings, as previously noted, specifically described the mechanism for transferring money from the New York Fed to the Bank of England, and for the return of a portion of those funds to the New York Fed for payment of the syndicated bank loans in which U.S. banks participated. Without both the Undertakings and the Implementing Technical Clarifications, the hostage deal was risky. However, with the Undertakings, of which Patrikis was unaware, the deal was secure. After approximately 45 minutes of careful thought and with the reassurance of officials in Washington that the documentation was adequate, Patrikis became satisfied that the U.S. and the New York Fed were protected and withdrew his reservation about the agreement.

There is nothing to support the allegations that Patrikis' concerns about the agreement were the product of a notion of Federal Reserve independence from U.S. government interference. All participants, both in Algiers and in Washington, have said that they viewed Patrikis as simply doing his job, in a conscientious and efficient manner, and that his concerns were legitimate and unrelated whatsoever to the issue of Fed independence.

In addition, so far as can be discerned, the claim that President Carter had a direct conversation with Patrikis in which he dictated digit-by-digit the telephone number of New York Fed President Tony Solomon is totally inaccurate. There were several telephone calls between Patrikis in Algiers and officials in Washington and New York to discuss Patrikis' concerns, and President Carter probably listened in on at least a portion of those conversations. After learning of the delay in Algiers, President Carter spoke with New York Fed President Tony Solomon and encouraged Solomon to resolve the problem. Solomon then spoke to Patrikis and Oltman, as well as Warren Christopher, in two phone conversations involving a careful analysis of all the documents that were to be part of the financial agreement. These conversations convinced the New York Fed officials that the United States was fully protected even without the disputed Annex, and Solomon authorized Patrikis to go ahead with the agreement. No one who was a party to any of these conversations recalls anything approaching the kind of dramatic confrontation between President Carter and Patrikis which is attributed in the previously quoted January 25, 1981 Washington Post article.

Contrary to the impression that may be left by certain accounts of the hostage settlement, there is no evidence that the Federal Reserve used the hostage negotiations as a forum for trumpeting its independence from U.S. Government control. All aspects of the Fed's participation in the Fiscal Agency relationship were premised on the willingness of the New York Fed to accept the directions of the Treasury Department. There is no evidence throughout the course of the hostage crisis that New York Fed officials were anything but being cooperative and prudent, and engaging in sound business practices, in their dealings with the Treasury Department and with foreign central banks.

VI. THE RESPONSES TO SPECIFIC ALLEGATIONS

This report has addressed at various points some of the criticisms leveled at the hostage settlement process, particularly at the roles played by the U.S. banks and by the Federal Reserve. This section discusses the most serious allegations that have been made and describes the facts so as to either corroborate or refute the charges.

ADVANCE PREPARATION OF FREEZE ORDER BY TREASURY AND STATE DEPARTMENTS

> Admissions by officials of the Federal Reserve Bank of New York also suggest that planning for the freeze had been going on for days, perhaps weeks, before Bani-Sadr's reported threat to pull Iranian funds out of U.S. banks.
>
> (Claudia Wright, "Buried Treasure at Chase Manhattan?", Inquiry, Apr. 7, 1980, p. 15.)

> Investigations by the staff of Rep. George Hansen (R-Idaho), with follow-up verification by The Spotlight, indicate that Treasury Department officials at top levels formally probed the possibility of freezing Iranian assets months prior to the embassy seizure in Iran and the taking of American hostages.
>
> There is reason to believe that Treasury began an in-depth analysis of a freeze of Iranian assets held in U.S. banks at the request of the Carter White House and banking kingpin David Rockefeller of Chase Manhattan Bank.
>
> Hansen's staff, again with independent confirmation by The Spotlight, was also able to ascertain that high State Department officials became involved in the process of determining the feasibility of freezing Persian money in late summer, 1979—around the same time Rockefeller and officials at state were making arrangements to admit the deposed Shah of Iran to the U.S.
>
> (H.D. Taylor, "Megabankers, Carter Schemed to Create Iran Crisis, Freeze Funds," The Spotlight, Feb. 9, 1981, p. 16.)

As described more fully in section I of this report, the U.S. government, as early as February 1979, did engage in contingency planning that included discussion of a freeze. Several memos were written within the Treasury Department discussing the authority for taking action against Iran, and draft regulations were prepared. The motivation for these memos apparently was concern, in the immediate post-revolution days, that Iran might conceivably take drastic action to change its financial relations with the U.S. While the political situation in Iran was extremely volatile during the December 1978–February 1979 period, the economic situation was far more calm. Military sales contracts signed by the Shah's government with U.S. companies were sure targets for cuts, but otherwise the financial picture was relatively stable. Thus there is no apparent reason why the consideration of a freeze under those circumstances in February 1979 progressed as far as it did, except out of either excessive concern for the consequences of Iran's instability or a desire by some Treasury officials to seize the initiative and the responsibility within the U.S. government relating to Iran. On the other hand, there is no evidence that these early freeze discussions were motivated by David Rockefeller or by the officials of any U.S. bank.

A major issue in The Spotlight article concerns the alleged linkage between the preparation of freeze orders and discussions that were centered in the State Department relating to the Shah's entry into the United States. There is no evidence at all that the State Department was involved in the preparation of freeze documents prior to the taking of hostages on November 4, 1979. Several offices at the Treasury Department, including the Office of Foreign Assets Control, International Monetary Control Office, and the General Counsel, looked into the President's options, including a freeze, under the International Emergency Economic Powers Act, as early as February 1979. None of these efforts involved the very top-level policymakers at Treasury or at State until after the hostages were taken.

In fairness, the fact that memos were written and outlines of Executive Orders and regulations drafted by Treasury staff before November 1979 is not an indication that anyone in government had concluded definitively that a freeze should be imposed on Iranian assets. As often happens, planning and drafting can go on at the staff level in anticipation of (rather than in response to) directions from the very top policymakers. This is especially true when the staff involved has had extensive experience in prior freezes (as was the case with the Office of Foreign Assets Control) so that the drafting portion of the contingency planning has become virtually second nature.

The Spotlight allegation also implies that freeze orders were drafted as a direct result of knowledge that the Shah was coming to the United States. We have found nothing to link the contingency planning with the decision to admit the Shah. For one thing, negotiations on the Shah's admission were conducted by officials at the State Department who were not involved in pre-hostage planning that included consideration of a possible freeze. Similarly, the planning in the Treasury Department was carried on by officials who had nothing to do with the Shah's admission. A second factor is that the monitoring of the Iran situation, by working groups both in the State and Treasury Departments, began long before the Shah's health became an issue and continued until after the hostages were taken. It is impossible to draw any conclusions from the fact that at one point in mid-1979 the ongoing U.S. government monitoring and planning concerning Iran occurred simultaneously with discussions about the Shah's admission to the United States.

TREASURY SECURITY PURCHASE BY THE SHAH

Why . . . did the administration agree to the shah's demand [to come to the United States for medical treatment]? The surprise answer could be that the shah—not as we were later told, the Iranian government—threatened to pull his investments out of the United States.

The U.S. Treasury knew it was entirely possible that since 1974 the shah had accumulated an enormous and secret stock of government securities, but because of Treasury's own rules about secrecy, there was no way to tell. It knew also that he had the option of "rolling over" these securities (repurchasing them as they reached their maturity) or alternatively, demanding cash and withdrawing his investments altogether. It was widely believed within the administration that a Saudi decision to pull out of treasury notes between November 1977 and August 1978—estimated to be a movement of approximately $11.7 billion—had produced the serious run on the dollar of late 1978. Without knowing with certainty the value of the shah's portfolio. U.S. Treasury officials

could have feared that it was at least the size of that of the Saudis, and possibly, even larger . . .

Even rumors of shifts of $1 billion to $2 billion were enough, in the volatile foreign exchange markets, to aggravate the dollar's decline. A significant withdrawal from the treasury-note market would mean that the budget deficit would have to be financed at rising interest rates.

In mid-1979 a report from the General Accounting Office said "that the sale of U.S. securities for the specific purpose of disrupting markets would not be a financial problem but would constitute 'economic warfare.' In this case the President might wish to invoke his powers to freeze assets under the International Emergency Economic Powers Act."

This was indeed what the President did on November 14, but not because the Iranian Government either threatened or was in a position to threaten to sell government securities.

Is there a way to explain both the admission of the shah to the United States and White House favoritism toward Chase? The most credible reason for administration actions—for which not a single publicly offered justification could possibly be true—has to do with a favor only the shah would have conferred and a threat only the shah could have made. The favor was concealed in the massive purchases of treasury notes late in 1978. The threat was simple—he would pull his money out.

(Claudia Wright, "Buried Treasure at Chase Manhattan?", Inquiry, Apr. 7, 1980, p. 15.)

Based on discussions with many of the principals involved in admitting the Shah, there is no indication that the Shah's alleged holdings of Treasury securities played a role in the negotiations.

The allegation itself assumes that Treasury was ignorant of the Shah's actual holdings of Treasury securities. If the Shah did not hold those securities in his own name or if a broker of some sort was used to purchase them, in fact Treasury would not know exactly how much the Shah may have held. Officials at the Treasury Department who are most familiar with transactions in Treasury securities say they were never asked for information about the Shah's personal or family holdings of those securities by any officials involved in negotiations with the Shah. Even assuming the Shah threatened to withdraw his purported holdings of Treasury securities if he were not admitted to the U.S., it is inconceivable that senior U.S. officials hearing such a threat would not have checked with their U.S. Government sources to get information about the Shah's holdings. No one involved in discussions concerning the Shah recalls withdrawal of the Shah's assets being part of the matters discussed. Therefore the issue of how much information the U.S. would have on the Shah's wealth and the impact of a withdrawal of his assets never played a role in the Shah's admission.

There is simply no indication that any part of this speculative sequence of events ever occurred.

CHASE MANHATTAN'S ROLE IN TRIGGERING THE FREEZE

The banking community, particularly David Rockefeller of Chase Manhattan, played a key role in getting the shah admitted. [A secret report to the House Intelligence Committee by Congressman George Hansen] suggests that Chase Manhattan deliberately set up the confrontation so that it could keep the Iranian government from withdrawing billions in oil revenue from its account at the bank. . . .

In discussing the pressure from Chase Manhattan and the Rockefellers' henchman, Henry Kissinger, the report notes that under the shah, Iran's oil revenues were deposited with Chase Manhattan to the tune of $20 billion a year. But

the revolutionary Iranian government began to withdraw its funds—a potentially serious "run" on the bank.

While Hansen stops short of accusing Chase Manhattan of engineering the hostage situation, he does point out that Carter's response—freezing Iranian assets in U.S. banks—prevented further withdrawals from the Rockefeller bank and ultimately allowed Chase Manhattan to seize the Iranian funds.

(Column by Jack Anderson. Washington Post, Mar. 24, 1980, p. C 23.)

After the shah fled Iran, the new government, knowing of Rockefeller's alliance with the shah and hating him for it, began pulling its money from Chase and depositing it in the foreign branches of other banks: Bankers Trust, Bank of America, etc. When that happened, Rockefeller had no reason to try to maintain friendly relations with Iran. But he had all the more reason to keep the shah's friendship, lest the exiled dictator pull his stolen fortune from Chase. So when the shah asked to come to America, Rockefeller and Kissinger put enough pressure on President Carter to bring it about, under the pretense that he was being let in for health reasons. Thus was triggered the long, debilitating tug-of-war over the embassy hostages.

Carter's decision to admit the shah was disastrous to this nation's peace of mind, but it was a fine decision for Chase Manhattan Bank and the whole banking system. If Rockefeller and Kissinger had failed to persuade Carter, and if that had prompted the sulking shah to pull his billions from Chase's vaults, what would have happened? As one Swiss economist explained with a shrug, "If you pull five billion dollars from Chase Manhattan, they will lock the door."

(Robert Sherrill, "Big Oil, Big Banks, Big Trouble." Penthouse Magazine, June 1980, p. 72.)

The chronology is interesting. The Iranians began to run down their account at the Chase in September 1979. Shortly thereafter Rockefeller, Kissinger, and McCloy began their new initiative at the State Department. The Shah a rived on October 25 and entered the Cornell Medical Center, where his condition immediately proved an enormous professional embarrassment. The Iranians blew up, and on November 4 the embassy and the hostages were seized. On November 5 the Iranian central bank sent a cable directing the Chase to withdraw $4,052,951.39 from its London account and use the proceeds to pay the next installment on its loan. The installment was due November 15. On November 14 Iranian Foreign Minister Bani Sadr suggested at a news conference that Iran might withdraw all of its funds from U.S. banks. At 4:00 A.M. on November 15. State Department officials set the freeze plan in motion, and the order was signed by the president four hours and ten minutes later. It extended to Iranian deposits in foreign branches. The European bankers didn't like that very much, but even more surprising was the part of the order that authorized the banks to use the overseas deposits to pay off any outstanding Iranian indebtedness at the overseas branches where Chase's share of the $500 million Iranian loan was conveniently located. Nothing like it had even been done before.

The Chase cabled the Iranian central bank that it was unable to transfer the installment because of the freeze, despite the fact that the transfer order had come ten days earlier. On November 19 the bank informed the other members of the syndicate that the loan was in default.

Amid the subsequent wave of seizures, attachments, defaults, mutual recrimination, and arcane legal maneuvering, a salient fact was forgotten: the Iranians had ordered the payment of the regular installment on November 5, from funds that remained fluid until the morning of November 15, and the Chase hadn't done it. All it would have taken was a few punches of the computer keyboard, and yet the Chase did not act. It sat on the money until it could legally grab it. There is also a curious coincidence. The Iranian installment was officially due at 10:00 A.M. on the morning of the fifteenth. The State Department was roused out of bed at 4:00 A.M. on the morning of that very day, and the president signed the freeze order at 8:10. The pretext was the Bani Sadr press conference. But it took the Iranians a full seven months to figure out how even to begin their withdrawal from the Chase, a bank they detested, and the process was still hundreds of millions of dollars short of completion when the roof fell in.

Whether he had planned it or not (who knows?—maybe he just wanted the shah's gallstone removed), David Rockefeller got his incident. The hostages were taken. The Europeans were outraged.

(L. J. Davis, "Hostages for the Chase Manhattan", Penthouse Magazine, December 1980, p. 174.)

Some of the factual elements of these allegations are correct. It is no secret that David Rockefeller and persons associated with him played an important role in the Shah's admission to the United States. It also is true that the Iranian government withdrew substantial deposits from Chase in the months preceding the hostage takeover, transferring those deposits to other U.S. banks such as Bank of America and Bankers Trust. A large portion of these deposits related to National Iranian Oil Company payments flowing from U.S. sources. Certainly Iran's movement of deposits at least in part was related to Chase's ties with the Shah.

Nevertheless, many of the conclusions in these allegations cannot be substantiated. While Iran at various times held fairly major deposits with Chase, the bank was hardly dependent on the deposits for its solvency. The daily cash flow of Chase's worldwide operations dwarfed the Iranian deposits. While a total withdrawal of those deposits would have hurt Chase, realistically it would not have been anywhere near a mortal blow driving Chase into bankruptcy, as the quotes from the Jack Anderson column and from Penthouse suggest. Indeed, one Chase official has described the effect on Chase of an Iranian withdrawal as a "hiccup".

Other factors also suggest that an Iranian withdrawal would not have been cataclysmic to Chase. Because of the recycling of these lost dollars that would occur through the Eurodollar market, U.S. banks could soon recover, at a premium price, dollar deposits that they lost (although any one bank would not necessarily recover its deposits dollar for dollar). Thus the withdrawal of Iran's funds from the U.S. would not necessarily have had dire consequences for the U.S. banking system. It also should be borne in mind that the Bani-Sadr threat to withdraw Iran's assets and repudiate its loans was not limited to Chase, but included U.S. banks generally. Since the threat was a general one, it could have affected at least two U.S. banks with greater deposit exposure (as of November 14) than Chase. Ironically, the actions already taken by Iran prior to November 14 in withdrawing large portions of their deposits from Chase made a freeze less and less vital to protect Chase's deposits, since that deposit exposure was constantly dwindling.

Much is made in the Davis article in Penthouse that Iran had ordered payment of its loan installment on November 4, but Chase did nothing until after the freeze was imposed. The freeze meant that Iran's deposits could not be touched, and therefore Iran was declared in default and its loan was accelerated. In fact, the terms of Iran's payment order prohibited payment prior to November 15. Legally Chase could not transfer money out of Iran's account on November 5 or on any day before November 15, when the installment actually was due. The image that Chase sat on the order for 10 days hoping for a freeze is false. In addition, the Davis article is factually incorrect in saying the freeze was imposed on November 15—the freeze occurred

the day before. There is no evidence that any government official who might have been in a position to affect the timing of the freeze was aware of the November 15 installment due date or any other loan repayment schedule.

The crux of the scenario painted by these articles is that Chase Manhattan engineered a freeze by convincing the government to permit the Shah to come to the U.S., knowing that that act would precipitate violence in Iran and make a freeze inevitable. While the scenario is ingenious, it assumes far too much predictability about the sequence of events in Iran and Washington. If anything was learned from the fourteen-month hostage ordeal, it was that reactions and counter-reactions regarding the Iran situation occurred without a discernible pattern. If past history were any guide, the previous attempt by militants to take over the Tehran Embassy, in February 1979, had resulted in Khomeini's emissary personally intervening to end the takeover. Even prior to the November 4 takeover, the Iranians were still promising protection for the Embassy. Thus, the taking of hostages, while predicted and feared by some, was hardly the kind of assured result of admitting the Shah on which Chase might base a business judgment. In short, there simply was no realistic way of knowing (except with the benefit of hindsight) what would actually happen at each turn of events in Iran.

The scenario also assumes that David Rockefeller's desire to help the Shah was motivated by Chase's financial interests. In some respects the opposite was true. Certainly it is impossible to speculate whether Rockefeller's association with the Shah was a net plus for Chase's balance sheet. Some observers believe that the Shah had far less wealth moving through Chase than is often assumed, and others say that the close identification of Chase with the Shah (whether that identification was warranted or not) had negative effects on Chase's business with other potential customers.

There is another line of rebuttal to the Penthouse allegations. This argument is that a freeze really was not in Chase's interest. Since Chase could protect itself with the traditional right of set-off, and since lost deposits could be recaptured eventually through Eurodollar recycling (albeit at some cost to Chase), a freeze was not needed. Even if Iran could argue that set-offs could not be taken against unmatured debt (after all, Iran was continuing to pay its debts before the freeze), the banks could tie up the deposits during the time that litigation to resolve the set-offs was pending. Some say that, rather than helping U.S. banks, a freeze served to damage the U.S. international financial system by casting doubt on the U.S. banks' ability to protect deposits from the whim of international politics. The exercise of the power to freeze, while understandable in the Iranian context, nonetheless raises the question when and under what circumstances this vast power might be used again. U.S. banks might well prefer not having to face that question when the next international crisis develops.

In summary, while some of the underlying facts are true, these scenarios are filled with conclusions that are more fanciful than real.

EXTRATERRITORIALITY OF THE FREEZE

A flurry of lawsuits on three continents also disputes the U.S. government's right to freeze assets in the U.S. branch banks in foreign countries, a possible contravention of local laws. Foreign banks "will neither forgive nor forget the way they have been treated," says a London banker.

(Penny Lernoux, "Citibank, Chase Acted as God by Freezing Iran's Assets." National Catholic Reporter, Feb. 29, 1980, p. 16.)

A good deal of controversy resulted from the U.S. decision to freeze Iranian dollar assets held in foreign branches of U.S. banks. Naturally, the Iranians challenged this aspect of the freeze in lawsuits filed in Europe, claiming the President had exceeded his power and violated the law of the branches' host countries. Most lawyers felt the U.S. had a risky legal position to defend. The initial reaction of the governments in the affected foreign countries was at best cool, and U.S. government officials moved quickly to try to reassure those countries by citing the extraordinary need for the freeze.

Why, then, did the U.S. take the legal and political risks of imposing a freeze on overseas accounts? The most important reason is that the freeze would not have worked without affecting Iran's assets abroad. The stated reason for the freeze was to protect American financial interests. No one was certain exactly how much U.S. banks, contractors and other entities had in outstanding claims against Iran, but it was quite clear that restricting the freeze to U.S. accounts, and ignoring the huge Iranian dollar deposits in Europe, could leave American financial interests with a relatively small pot of funds to secure the payment of Iran's obligations. Furthermore, by blocking only the $2 billion held in the U.S. and leaving the more than $5.5 billion held overseas open to withdrawal by Iran, the U.S. would have lost substantial leverage in its bargaining to gain release of the hostages.

Overseas assets also enjoyed an important legal advantage in this situation. Attachments and other restraints on the movement of funds were harder to get under foreign law, and the expense of going abroad to try to get attachments certainly deterred some U.S. claimants from seeking them. On the other hand, Iran's frozen assets in the U.S. almost immediately after the freeze ultimately were subjected to over 400 lawsuits seeking prejudgment attachments and other legal relief. The difficulty raised by attachments, from the standpoint of the U.S. government, was the possibility that legal complications at the last minute could slow down or even prevent fast transfer of money to Iran as part of a hostage agreement. Therefore, as the situation developed, it was important to have the overseas assets that could be moved quickly and without major fear of last-minute legal snarls.

At least partly in response to concerns expressed to them, the Treasury Department took several regulatory actions soon after the November 14 freeze to mitigate the impact of the freeze overseas. First, Treasury permitted set-offs of loans held abroad to be taken by U.S. banks against overseas assets. This had the effect of placing a smaller amount of money in actual jeopardy in the event the extraterritorial freeze was eventually overturned. In addition, the U.S. government's

licensing of set-offs meant that U.S. banks were likely to take a far more active role in defending the U.S. actions taken abroad under the freeze.

Another early Treasury Department regulatory decision was to clarify that the freeze did not affect either foreign banks in Europe or non-dollar accounts in U.S. branch banks overseas. This narrowed the exposure of foreign currencies to the freeze, while still leaving a significant dollar deposit pool covered by the U.S. blocking.

Some have argued that the freeze was unnecessary to protect U.S. banks since they could have used the self-help mechanism of setting off their loans against their deposits even without a freeze. As described elsewhere in this report, however, various banks were in different positions with respect to the asset and liability sides of their Iranian portfolios. Some had more deposits than loans; others were in the opposite position. Thus a reliance on bank deposit set-offs alone would not help banks equally, nor would it help non-bank claimants. Furthermore, there was a serious legal question about whether loan acceleration clauses and set-offs could be invoked legally under loan agreements with Iran prior to an Iranian default. Although the revolutionary government in Iran had made some general statements threatening to repudiate the U.S. loans, other statements had been more reassuring and Iran had continued repaying its debts. It took the freeze itself, and Iran's order that Chase debit a blocked account to pay an installment of its $500 million syndicated loan, to trigger a default, followed by an acceleration and a series of set-offs by the U.S. banks. There is further discussion on this acceleration issue in the response to the next question. With the respect to a freeze, however, an across-the-board government blocking provided a more equitable preservation of the status quo for all claimants than would have been the case with pure self-help remedies by the private parties.

There were, on the other hand, negative aspects of the extraterritorial freeze. The theory (if not the actual operation) of the Eurodollar market was seriously undermined by applying the freeze abroad. The Eurodollar market was created to avoid U.S. regulatory restrictions and to protect transactions in dollars from domestic political pressures. The extension of America's freeze to Europe's shores, however justified by the hostage crisis, cast doubt on the degree to which Eurocurrency transactions (particularly those carried out by subsidiaries of U.S. banks) could be insulated from U.S. political and foreign policy decisions. In the short run, it is fair to say that the Eurodollar market has not been devastated by the freeze. Any shifts in activity from international to national capital markets in the last year or more are equally well explained by reasons wholly unrelated to the freeze as by the freeze itself. Whether there will be a severe long-run impact on activity in the Eurodollar market remains to be seen, but without question those who theorized about the rationale for the Eurodollar market have been forced to reassess their positions after the freeze.

OVERREACHING BY U.S. BANKS IN IMPOSING SET-OFFS

The freeze also caused a nasty international squabble about Iran's assets, not only between U.S. giants in New York and their European bank partners but with the small U.S. banks as well.

Contrary to banking conventions, Citibank, Chase Manhattan, Bankers Trust and Manufacturers Hanover Trust peremptorily seized the Iranian money, which

they declared in default, to protect their portion of syndicated Iranian loans (these are loans subscribed to by many banks of different nationalities).

This left the other partners in the syndicate out in the cold, without assets to cover possible losses, including European and Japanese banks and smaller U.S. banks such as Security Pacific National Bank in Los Angeles and U.S. Trust Co. of New York. None was consulted by the large U.S. banks about the seizure.

The banks' action brought into question legal loan covenants requiring syndicate partners to share out such assets (of the $8 billion frozen, $2.5 billion was owed to U.S. banks). . . .

The hasty seizure of Iranian deposits by the four New York banks, which form part of the Rockefeller-Morgan Group, was prompted by Chase's decision to call a syndicated $500 million loan to Iran in default Nov. 19. It did so in spite of the protests of the four European and Canadian banks in the syndicate. Chase claimed Iran had not paid $4 million in semi-annual interest on the loan, but failed to mention that on Nov. 5, well ahead of the due date, the Iranian central bank authorized Chase to transfer funds to pay the interest.

Chase later said Carter's freeze order Nov. 14 had prevented it from transferring the interest, although that was nine days after the Iranian transfer order.

(Penny Lernoux, "Citibank, Chase Acted as God by Freezing Iran's Assets", National Catholic Reporter, Feb. 29, 1980, p. 16.)

Following the November 14, 1979 freeze, the Treasury Department quickly authorized U.S. banks to set-off their overseas loans to Iran against Iranian deposits in their foreign branches. In issuing its regulation, Treasury was responding to a number of phone calls from U.S. banks in which the banks said the freeze order, as drafted, would prevent them from protecting themselves with set-offs. The Treasury regulation, issued soon after the freeze, said in effect that the freeze did not preclude set-offs, but Treasury took no position on the legal validity of any particular set-off that a bank might choose to take.

With this authority, the U.S. banks imposed set-offs after Iran missed payment on the November 15 installment of its Chase-led syndicated loan. As described in the answer to a previous question, Chase acted properly in not transferring funds before November 15 to pay that installment. The Iranian instruction dated November 5 did not permit transfer before the actual due date of the installment.

When the November 15 payment was missed, U.S. banks who were syndicate leaders for Iranian loans polled the other members of their syndicates to see whether acceleration clauses in the loan agreements should be exercised and the loans declared in default. Most of the loan agreements required approval by syndicate members holding a majority of the syndicate shares before default could be declared. In some cases, non-U.S. banks held a majority interest, and those banks would often favor not taking action against Iran. Since the U.S. freeze did not affect those foreign banks and Iran could pay into accounts at those banks without having funds blocked, foreign banks expected that Iran would continue to pay portions of the installments due to non-U.S. bank syndicate members as they came due, despite the U.S. freeze. (In fact Iran did continue to pay many non-U.S. banks throughout the period of the freeze).

U.S. banks, on the other hand, could not anticipate that Iran would continue to pay into blocked accounts. Therefore many U.S. banks were anxious to use the traditional set-off remedy and, because of the uncertainty about how long the freeze would last, to declare the loans in default and accelerate payments. When U.S. banks held the majority interest in the syndicates, this tended to be the result that occurred soon after the freeze was imposed. Some U.S. banks did not

have enough deposits in their own bank to cover their loan exposure, but many were protected anyway. Under what became known as the "black hole theory," banks that held large Iranian deposits set-off more than their own shares of the defaulted loans. They did this because provisions in some syndicate agreement required a syndicate member receiving a windfall payment to share that windfall with other members of the syndicate. Thus there was no assurance that any one bank setting off just its share of a loan could keep it all for itself; rather the bank ultimately might have to share it with other banks. The result was that some U.S. banks set-off larger amounts to protect themselves, and other syndicate members as well.

There is no indication that the U.S. banks that accelerated payments and took set-offs did anything that violated U.S. banking law. Indeed, the allegation prompting this discussion speaks largely of a "squabble" among various banks rather than of any formal violation of law or U.S. official policy that would prompt the Committee's concern.

ILLEGAL BANK CONTACTS WITH IRAN

Did certain financial interests in the United States with risky investments unduly and even dangerously influence American foreign policy even to the point of Logan Act violations?

(Letter to President Reagan from Congressman George Hansen, Feb. 2, 1981.)

This charge alleges that Citibank's contact with Iranian intermediaries through John Hoffman (and similar contacts involving other banks) adversely affected U.S. foreign policy and may have involved a violation of the Logan Act. This charge is discussed in some detail in the chapter on the informal bank negotiations. The conclusion reached in that chapter was that the Hoffman contacts were appropriate, were valuable from the standpoint of the U.S., and were fully sanctioned by the U.S. government under strict guidelines that precluded a Logan Act violation. The Act (18 U.S.C. § 953) is a criminal statute that provides as follows:

§ 953. PRIVATE CORRESPONDENCE WITH FOREIGN GOVERNMENTS

Any citizen of the United States, wherever he may be, who without authority of the United States, directly or indirectly commences or carries on any correspondence or intercourse with any foreign government or any officer or agent thereof, with intent to influence the measures or conduct of any foreign government or of any officer or agent thereof, in relation to any disputes or controversies with the United States, or to defeat the measures of the United States, shall be fined not more than $5,000 or imprisoned not more than three years, or both.

This section shall not abridge the right of a citizen to apply, himself or his agent, to any foreign government or the agents thereof for redress of any injury which he may have sustained from such government or any of its agents or subjects.

It seems clear that Hoffman's care in first asking U.S. government permission and then in keeping the U.S. fully informed of his contacts makes it unlikely that a successful Logan Act prosecution could occur. This is especially so in view of a 1964 court holding that any ambiguity in the Logan Act should be resolved in favor of lenity. *Waldron* v. *British Petroleum Co.*, 231 F. Supp. 72 (D.C.N.Y. 1964).

FAVORED POSITION OF BIG BANKS UNDER SETTLEMENT

> The big American banks that lent money to the Shah's Iran are almost as happy as the families of the 52 hostages. They are the biggest gainers from the financial unravelling that accompanied the hostage deal. . . .
>
> The big international banks—American, Japanese, and European—are completely relieved of their outstanding loans to an unstable country that might well default. Companies and individuals with claims against Iran, however justified, are going to have a scramble for a share of what they can get.
>
> (Article entitled "Bully for Banks, Messy for the Rest," The Economist, Jan. 24, 1981, pp. 20–22.)

There is really no question that the U.S. banks involved in syndicated loans were pleased with the full payoff of those loans provided under the hostage settlement agreement. To the extent any doubts might have existed about Iran's willingness to honor its syndicated loan commitments, the hostage agreement resolved them. Other claimants are not assured of being paid in as timely and certain a manner.

To say this, however, is not to concede that the agreement is tainted by favoritism. Indeed, the claimants now have available the Claims Tribunal as a forum for resolving disputes with Iran, and so in many cases may be better off than before the hostage settlement. At least some of the non-bank claimants would have been forced to rely on the uncertainties of Iranian courts to settle disputes under the terms of their original contacts with Iranian parties. Now there at least will be a neutral arbitration panel to render judgments. In addition, Iran has agreed to the enforcement of those judgments against Iranian property located anywhere in the world, therefore waiving potential sovereign immunity defenses against property belonging to the Iranian government. The U.S. government has also agreed to handle relatively small claims before the Tribunal, thereby saving some costs to claimants who might otherwise not be as able to use the arbitration mechanism.

One critical fact that explains why the hostage settlement came out as it did was that it was the banks, rather than the contract claimants, that held the cash and other liquid deposits that Iran demanded in exchange for the hostages. This meant that there had to be a reasonable untangling of the complicated asset and liability web with Iran before those funds could move. Since it was basically the large U.S. banks that held those deposits and made the loans, it is sensible that the ultimate financial agreement was a good one for the banks. Furthermore, these banks held assets in the form of readily quantifiable loans, while contract claims were less easy to quantify. This was a crucial factor given the rapidity with which it would be necessary to close the financial deal with Iran.

Finally, and perhaps most important, it was Iran, and not the U.S. banks or the U.S. government, that came forward with the proposal on January 15 that broke the negotiating logjam. That proposal was structured in a way that made payoffs of the bank loans the natural way to go given the time constraints and the financial concessions Iran was willing to make.

All of these elements undoubtedly influenced the outcome of the agreement, but there is no reason to believe either that chicanery was involved in structuring the deal or that the interests of non-bank claimants as a whole were not fairly protected in the agreement. Whatever criticism maybe directed at the U.S. Government for its role in negotiating the claims settlement is discussed in Part IV of this report.

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